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January 1991 (First of Two January Issues)

WELFARE REFORM

Support For Welfare Reform: The motivations for state officials, the federal government, taxpayers, compassionate citizens, and profit-maximizing business leaders to be concerned with reforming welfare are all strong.

Welfare remains consistently and thoroughly unpopular, as shown by every public opinion poll looking at the question. Working people and people living on pensions they earned by working simply don't like the idea of paying money to able-bodied persons who don't work. The sympathy for paying for mothers of young children to stay at home with their children has been eroded as more and more taxpayers discover they cannot afford to have a parent be a full time homemaker. There is considerable indication that welfare recipients themselves hate the system, viewing themselves as being "trapped on welfare." There is overwhelming evidence that the consequences for children of growing up in welfare households are undesirable in just about every dimension.

Federal and state officials lament the costs of welfare and the expensive income-tested, oft-criticized programs (e.g., public housing, Medicaid) that accompany it. They lament the loss of revenue because potentially productive people are not working. So do business leaders who in broad terms are starting to worry about a labor shortage and in narrow terms don't understand why they can't get applicants for lower wage jobs while many people who could take them remain on welfare. To top it off, even the professionals, such as caseworkers, have a loathing for their work unmatched in the aggregate by highway workers, teachers, health care workers, and workers in traditional private sector jobs.

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Some of these criticisms are not new. They used to be considered "conservative," but are now appearing from all points on the political spectrum. The problems with welfare and with the new welfare reform legislation were anticipated in a special NCSL conference last year (see "Beyond Welfare" in Issue 11). The criticisms have produced an environment in the legislatures that has kept welfare grant levels from being raised to match inflation, even in years when state finances have been in relatively good shape. In a year like 1991, they are likely to make increases in AFDC and general assistance grant levels a rare phenomenon in state budgeting.

The Latest Reforms: Small wonder that considerable energy has gone into programs designed to take people off the welfare rolls and put them onto the job rolls. Federal initiative for decades produced an alphabet soup of these as the latest approach not to work was replaced by the newest approach with its hopes that it would work. All of this was to end as state officials seized the initiative with new programs like ET in Massachusetts and GAIN in California. The highly touted results were followed by programs in other states and federal adoption as a requirement. The federal legislation marked an end to a debate that had gone on for decades over requirements that welfare recipients work. Liberals, who had opposed work requirements, agreed that all recipients but those with the youngest children would be required to work or at least prepare for work. Conservatives agreed that the work requirement wouldn't be punishment for being on welfare or a threat to recipients but a chance for a better life by escaping the trap of welfare dependency.

Two kinds of glue held the agreement together. The first was the promise that the provision of education, child care, job preparation and counseling, continuation of benefits after employment for a transition period, and job placement activities would be cost-saving or at least cost-neutral -- if not in the first year at least over time. So the savings in reduced welfare and other income-tested programs would, over time, equal the outlays to make welfare recipients ready for work and find them jobs. The second bit of glue was that, in practice, the work requirement would be contingent on the social services. That is, the welfare recipient wouldn't be expected to work if the states couldn't or wouldn't provide the supporting services called for by the plans.

What Appears To Be Happening: There is still dispute over how helpful the state strategies for putting welfare recipients to work have been. There is no doubt that many people have left these programs for jobs. Nor is there doubt that many people leave welfare for jobs without these programs. To evaluate the effects of the programs it is necessary to match two comparable groups and see whether a larger percentage served by programs get jobs than those who don't receive the extra services. The subjects must be tracked for a considerable period of time because if the programs don't provide relatively permanent substitutes of working for welfare, they clearly aren't cost effective. Getting many of these kinds of studies is difficult because they are expensive and inherently involve denying some people services while others similarly situated are provided services they want and program administrators say they need.

Without this kind of information, state officials can't easily tell whether the welfare reform programs save more in future AFDC costs than they cost for social service and education investments. They already know that -- in the short term, reflected by the budgets in any year -- the costs are additive. This is, by adding $1.00 in social services to help welfare recipients get work they can't subtract $1.00 in AFDC payments in the current AFDC budget. If they suspect they can't ever subtract anything, support for welfare reform funding tends understandably to dry up.

From Welfare To Jobs In New Jersey: The New Jersey legislature cut welfare reform funding in the 1990 legislative session. To find out the results, the House Appropriations Subcommittee dealing with social programs invited selected county welfare directors to discuss their experiences in an October hearing.

The welfare director of Essex County, which has 28% of New Jersey's welfare caseload, explained that a welfare mother needs to make about $8 an hour to "break even." Breaking even involves offsetting the cash benefit ($424 a month), federal food stamps, Medicaid, and some version of the transportation and child care costs associated with working. The average starting salary of the jobs being provided through welfare reform were, he said, about $6.20. He and the other county officials urged legislators to stop equating the success of welfare reform with statistics about the number of people getting jobs.

Welfare Rolls Increase: Welfare caseloads were relatively constant through the 1990s, so the primary cost increases for states were: (1) increases in cash grant amounts, generally below inflation and (2) increases in Medicaid costs for the welfare caseload, generally above inflation by a substantial margin. In the last year, there have been major increases in the AFDC population in nearly every state. For example, in December, Pennsylvania's welfare department announced that growing caseloads could produce a shortfall in cash payments of $87 million, plus the Medicaid shortfall associated with the higher caseloads.

California's long-term outlook, as calculated by the Commission on State Finance, is for a continuing increase in welfare caseload, with a 3.1% increase in FY 1992 and increases above 2% in the rest of the early 1990s.

The Alternative To Reform: Welfare reform, beyond what is required by federal law, can be abandoned by refusals to fund. In broader terms, it can be abandoned or deemphasized by emphasis on children directly rather than indirectly by seeking to assist the family unit. This sounds radical, but has already appeared in the Medicaid program. There, the family unit concept is being abandoned in favor of a concept of entitlement oriented toward children.

Because money spent on caseworkers who work with adult clients is money that could be spent on children, some advocates for children have questioned some aspects of welfare reform. For example, in commenting in October on state welfare policy, the executive director of the Association for Children of New Jersey commented, "My frustration is we've had federal welfare reform and state welfare reform and we still see hundreds of thousands of kids in poverty. Maybe we need to rethink how much of that money is being spent on a welfare bureaucracy and maybe we need to find creative ways to help these children."

Comparing State Efforts To Help Children: There are many different ways of assessing how well each state is treating children through state government policy decisions. The Children's Defense Fund uses 20 different measures. The result grades states highest if they have relatively generous welfare and medicaid programs and have made recent progress in improving on indicators like infant health. The scores appear on Table 1.

Table 1: Children's Defense Fund Report Card Scores. 1990

Rank	State	Score	Rank	State	Score	Rank	State	Score
1	Vermont	65	17	Alaska	35	31	Montana	25
2	Maine	60	17	Iowa	35	31	Nebraska	25
3	Massachusetts	55	17	Michigan	35	31	North Carolina	25
3	Minnesota	55	17	North Dakota	35	31	Oklahoma	25
5	Connecticut	50	17	Virginia	35	31	Oregon	25
5	Delaware	50		**United States**	**32**	31	Texas	25
7	California	45	23	Arkansas	30	31	Utah	25
7	South Carolina	45	23	Florida	30	31	Wyoming	25
9	Illinois	40	23	Hawaii	30	42	Arizona	20
9	New Hampshire	40	23	Maryland	30	42	Georgia	20
9	New Jersey	40	23	Nevada	30	42	Mississippi	20
9	New York	40	23	Ohio	30	42	Missouri	20
9	Pennsylvania	40	23	Tennessee	30	46	Colorado	15
9	Rhode Island	40	23	West Virginia	30	46	Idaho	15
9	Washington	40	31	Indiana	25	46	Kansas	15
9	Wisconsin	40	31	Kentucky	25	46	South Dakota	15
17	Alabama	35	31	Louisiana	25	50	New Mexico	10

CORRECTIONS COSTS AND RESULTS

Introduction: Growing corrections costs continue to be a major factor in preventing states from being able to finance current state services without tax increases.

The main cause of the problem is the growing number of prisoners. From July of 1989 to July of 1990, there was an 11.9% increase in the nation's prison population. It costs roughly $25,000 to hold a prisoner for a year in state prison systems. So the 80,000 increase in inmates costs about $2 billion. Over 90% of prisoners sentenced to a year or more are in state, rather than federal, institutions. Assuming that the 80,000 new inmates required building additional facilities at $55,000 a cell, another $4.4 billion was required for construction.

In addition to expanding prison capacity and increasing operating costs for new prisoners, many states are increasing the costs of their corrections systems in response to litigation about prison conditions. These have led to consent decrees in many states that commit the state to designated improvements in conditions and the costs associated with those improvements.

Differences Among States In Inmate Increases: The states show quite dissimilar patterns in the trends in their total prison populations. This suggests that there are significant differences in state policies affecting the results. Table 2 shows the most recent statistics.

An examination of Table 2 emphasizes the importance of state policy choices in determining the growth of correctional populations. If demographic or economic factors were at work, one would expect to find economically and demographically similar states with similar increases in prison populations. This pattern doesn't appear in the table. Illinois led the nation with a 21% increase, but neighboring Indiana had a 2.5% increase and Wisconsin a 5.5% increase. Texas had a 19% increase, but Oklahoma was under 7%. Kansas showed a decline while Nebraska showed an increase of nearly 10%. The New England states varied from 2.7% in Rhode Island to 16.3% in New Hampshire.

Table 2: Percentage Increase In Prisoners, July 1989 to July 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Kansas	-8.1%	18	North Dakota	7.7%	34	New York	12.3%
2	Mississippi	0.0	19	South Dakota	7.8	35	Maine	12.5
3	New Mexico	0.3	20	Minnesota	8.4	36	Idaho	12.8
4	Alaska	0.5	21	Alabama	8.7	37	Arkansas	12.9
5	Montana	1.7	22	Arizona	9.3	38	Kentucky	12.9
6	Indiana	2.5	23	Nebraska	9.6	39	Pennsylvania	13.1
7	Rhode Island	2.7	24	Wyoming	9.6	40	California	13.2
8	Nevada	3.2	25	Georgia	9.7	41	Ohio	13.5
9	Hawaii	4.3	26	Colorado	9.9	42	Maryland	13.6
10	North Carolina	4.4	27	Utah	10.2	43	Vermont	13.6
11	West Virginia	4.7	28	Massachusetts	10.3	44	Virginia	14.0
12	Oregon	4.8	29	Michigan	10.6	45	Iowa	15.7
13	Tennessee	5.4	30	Louisiana	10.8	46	Washington	16.0
14	Wisconsin	5.5	31	South Carolina	11.0	47	New Hampshire	16.3
15	Delaware	6.8		**United States**	**11.9**	48	New Jersey	16.5
16	Oklahoma	6.8	32	Florida	12.3	49	Texas	18.9
17	Connecticut	7.6	33	Missouri	12.3	50	Illinois	20.9

Incarceration Rates: Table 2 is a one-year snapshot of the increase in incarceration. The incarceration rate, shown on Table 3, reflects the number of prisoners related to population.

Table 3: Number of Prisoners Per 100,000 Population, July 1990

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	North Dakota	66	18	South Dakota	184	34	Missouri	291
2	Minnesota	73	19	Idaho	193	35	Ohio	293
3	West Virginia	83	20	Colorado	206	36	California	303
4	New Hampshire	114	21	Tennessee	206	37	Mississippi	303
5	Vermont	115	22	Connecticut	223	38	New York	304
6	Maine	124	23	Kansas	224	39	Georgia	318
7	Iowa	135	24	Indiana	225	40	Florida	328
8	Massachusetts	135	25	Illinois	233	41	Delaware	333
9	Utah	141	26	Oregon	233	42	Maryland	339
10	Wisconsin	141	27	Wyoming	233	43	Alabama	348
11	Nebraska	147	28	Kentucky	237	44	Alaska	355
12	Rhode Island	151	29	North Carolina	261	45	Michigan	357
13	Washington	152	30	New Jersey	268	46	Arizona	369
14	Hawaii	159	31	Arkansas	274	47	Oklahoma	370
15	Montana	174	32	Virginia	276	48	Louisiana	421
16	New Mexico	181	33	Texas	280	49	South Carolina	443
17	Pennsylvania	181		**United States**	**289**	50	Nevada	463

The differences among states are massive. There are ten states that have half the ratio of prisoners to population as the nation. Many of these are predominantly rural states with a population somewhat older than the national average, but the list includes Minnesota, Massachusetts, and Wisconsin. Some states are strikingly above the national average. Nevada's high incarceration rate is presumably related to the large number of tourists attracted to the state, but such explanations don't explain the high rates in South Carolina, Louisiana, Oklahoma, Arizona, and Michigan. The cost implications are substantial. At $25,000 a prisoner year, South Carolina could save the costs of 6,888 prisoners, or $172 million a year, by moving to the same incarceration rate as North Carolina. By moving to the national average, it could save $146 million annually.

Jails: In most states, local jails are used for short sentences and holding persons awaiting trial. But there are differences among states in circumstances where inmates are sent to jail or prison and some smaller states (e.g., Connecticut and Hawaii) have combined local jails and state corrections systems.

Nationwide there were 144 persons in jail (1988) per 100,000 population. There is a definite regional pattern with the least use of jails in the Midwest (85) and the most in the South (171) and the West (185). Jail populations grew by 54% in the five years ending in 1988.

Probationers and Parolees: The increase in prison populations is paralleled by an increasing number of persons on probation and on parole. From January of 1981 to January of 1989, there was an increase of 114% in jail and prison populations. This slightly exceeded the increase of 107% of those on parole, but was less than the increase of 126% of those on probation. At any point in time, about three-fourths of all convicted offenders are under community supervision -- probation or parole -- rather than in prison. At the end of 1989, 4.1 million adults, about 1 in 46, was under the supervision of a corrections agency -- 62.2% on probation, 16.8% in prison, 11.3% on parole, and 9.7% in jail.

Patterns among states in probation policies vary substantially as shown for selected states on Table 4. The first column is the percentage change during 1989 in the number of persons on probation. The second relates the number of probationers at the end of 1989 to each 100,000 adults.

Table 4: Probation In Selected States, 1989

State	Pct. Inc.	Per 100,000
Florida	16.3%	1,964
New Jersey	15.3	1,131
California	7.3	1,335
Virginia	6.4	414
United States	5.6	1,369
Illinois	3.5	1,083
Minnesota	3.1	1,819
New York	2.8	946
Texas	0.8	2,419

Use Of Parole: The range of options being decided differently in individual states, presumably with substantial implications for costs and crime, is no better illustrated than by the use of parole. Nationwide, in 1989, the population on parole increased by 12.1%, roughly equivalent to the 11.9% increase in prisoners. But sharply different state policies constitute this national average. Major one-year decreases in the population on parole were made by states like Massachusetts (-13%), Rhode Island (-12%), Florida (-10%), Kentucky (-9%), and Washington (-8%). At the same time, the use of parole was greatly increased in Georgia (54%), Kansas (37%), Oklahoma (37%), Michigan (29%), Alabama (22%), Vermont (21%), and California (16%).

The variation in the parole policies of the states also appears on Table 5, which shows the number of persons on parole at the end of 1989 as a percentage of the adult population.

Table 5: Parolees Per 100,000 Adults, End 1989

State	Number	State	Number
Connecticut	13	**United States**	**248**
Florida	24	California	269
Arizona	80	New York	270
Indiana	84	New Jersey	340
Wisconsin	122	Georgia	376
Illinois	168	Pennsylvania	519
Alabama	191	Texas	758

Corrections In New Jersey: New Jersey is typical of the states where corrections costs represent bad news. The major tax increases of 1990, which have been highly unpopular, were aimed at other priorities such as relieving property taxes and improving the schools, particularly in areas with high poverty concentrations. Now, with revenues less than anticipated, major cuts are being discussed in other state programs to avoid another tax increase. In a recent seminar sponsored by the Partnership for New Jersey (a Business Roundtable-type organization), experts talked about an increase of 7,600 more inmates than current capacity -- $500 million or so in added capital costs and $190 million a year in operating costs. Panelists discussed reasons which included using stiff prison sentences for drug offenses and an apparent shift of parole authorities toward less generous use of parole.

Corrections In Illinois: Although there is talk in Illinois -- the state with the highest growth rate in prisoners shown on Table 2 -- that the state cannot build its way out of the prison problem, considerable building has been going on. From FY 1978 to FY 1990, the state added more than 11,000 prison beds by expanding existing facilities and constructing a dozen new ones. Current corrections agency projections show the inmate population rising from just over 20,000 in 1989 to over 30,000 around 1993 and 40,000 by the year 2000.

Dealing With Corrections Costs: Comparing costs of the corrections function among states is difficult because of differences in cost accounting among the states. For example, some states budget employee benefits, like health care and pensions, in central accounts while others include them with agency accounts. A New York study published earlier this year provided a comparison among major states that showed the cost differences shown in Table 6.

Table 6: Operating Cost Per Inmate, FY 1988

State	Cost Per Inmate	State	Cost Per Inmate
New York	$25,286	Pennsylvania	$14,054
Michigan	21,324	Florida	13,819
California	19,568	North Carolina	13,765
Illinois	18,613	Texas	13,142

The major factor affecting operating cost differentials is likely to be the pay of corrections officers. Differing staffing ratios are probably also a factor, but it is difficult to sort out in-prison guard staffing from overhead staff when comparing the corrections systems of different states.

EDUCATION CHOICE

Introduction: Interest in education "choice" plans continues despite recent rejections by Wisconsin courts and Oregon voters.

Federal Endorsement Of Choice: As one of his last acts before losing his job (replacement: former Governor Alexander of Tennessee), Education Secretary Cavazos announced the creation of a choice "outreach office." The new Center for Choice in Education will be a clearinghouse on the subject, complete with its own "hot line" (Call 1-800-422-PICK). For federal purposes, choice includes (1) private school options with public funding through tuition tax credits or vouchers, (2) home schooling, (3) special choices presented by dropout-prevention centers and the option given high school students to take college courses, (4) choices among school districts, and (5) choices within school districts generally and the special situation of magnet schools.

Education Organizations Oppose Private School Support: At about the same time the Education Department made its announcement, ten education groups announced their opposition to using public funds to support private schools. The groups included the American Federation of Teachers, the National Education Association, the National PTA, and various administrators' groups. Some of these groups support choice among public schools, at least in some circumstances, but feel support of private schools will weaken public schools.

Wisconsin's Plan: There are just under 400 Milwaukee pupils enrolled in private schools this school year under the state's new choice plan. The inner-city students are the nation's first to attend schools under such a plan, which developed out of a unique coalition of inner-city legislators and conservatives. While there have been some decidedly favorable journalistic reviews (see, New York Times, 12/19), it is much too early to assess educational results. There are many eager watchers, including the President, who has called it "one of the most interesting experiments in education reform."

The opponents of the Milwaukee plan, apparently led by the Wisconsin education department, mounted a court challenge. It lost in the court of first jurisdiction. On appeal, the opponents won on a procedural issue related to how the legislation was passed. It was attached to the omnibus bill that, in Wisconsin, as in some other states, wraps up the budget compromise and a variety of substantive legislation. This practice is subject to attack as violating constitutional requirements that bills deal with a single subject and that local benefit bills be voted upon separately from statewide legislation. On this ground, the Wisconsin appellate court rejected the legislation in a November decision. The next stop is the state supreme court.

Oregon's Educational Choice Measure: The educational choice measure was rejected by a two-to-one margin in Oregon. Because the measure combined two elements, it is difficult to categorize it as either representing a pure vote on privatization of government functions or choice movements for public schools, though it did represent a vote on both school choice philosophies considered together.

Conceptually, the measure was equivalent to the scholarship programs run by most states. The financial aid becomes an attribute of the student, rather than of the school. The student carries the aid entitlement to the school of choice, regardless of whether that school is managed by government, a private non-religious group, or a religious group. The policy argument for this choice was that it allows the student to match needs with educational offerings and forces providers to tailor their offerings to the perceived needs of students, tending to lead to efficiency in a marketplace sense.

One argument against the plan was that it would lead to subsidizing providers considered undesirable -- including state support of religiously oriented institutions (which now occurs with universities, hospitals, and day-care providers). Another argument was that the freedom of choice would lead to a concentration of hard cases and undesirable situations in central facilities, such as central city schools (which now occurs with central city hospitals). Opponents argued that choice would be ineffective for the poor because they couldn't afford transportation. Proponents argued the rich already have choice because they can pay tuition and transportation, so the measure is extending choice. Opponents contended that the schools would have the option of setting admission standards and would tend to "cream-skim" leaving the hard cases to the public sector.

The math of the proposition was hotly disputed in Oregon, but the underlying economics was relatively simple. There are already some students in private schools who would be there with or without subsidy. These students would give rise to subsidies of $2,500 per student, with a loss to taxpayers and a gain to those now paying of the amount involved. Those interested in public schools view this as a deadweight cost of the program, adding to taxpayer costs without changing anything. Others view it as a partial end to the free ride taxpayers have been getting from those who pay for education twice -- once as tuition-paying parents and again in taxes to support public schools their children don't use.

For students who would make the choice of private schools under the program, but wouldn't otherwise, the plan represents a savings of the costs of educating a child in the public schools, which is more than the subsidy, if the public schools adjust their spending proportionally to the change in enrollment, which school officials claim they cannot. The Oregon measure had a complex mechanism designed to capture the state and local taxpayer savings and use them to offset the costs of the subsidy.

Because of doubts about the constitutionality of direct payments to schools, the subsidy was packaged as a refundable credit against Oregon's income tax. Proponents believed this puts it squarely within the precedent of the U.S. Supreme Court's approval of Minnesota's tuition tax credit. Opponents didn't agree. Had the measure passed, they would likely have litigated the issue as far as the court system would let them.

The other portion of the Oregon choice plan involves choice among public schools, including the transfer of both state and local taxpayer support among school districts when a student selects a school in another district.

The measure appeared to be slightly ahead in some of the early polling, but the campaign against it used most of its substantial resources just before the election. The opposition campaign stressed that the plan would involve turning public funds over to private groups with no control over the selection except whatever control might be exercised by the parents.

Choice In Other States: Some version of choice plans now exist in Minnesota, Iowa, Arkansas, Nebraska, Ohio, Utah, and Idaho. There is significant support of students attending private institutions in the Iowa and Minnesota plans. There are demonstration plans in some other states, such as plans adopted by Colorado and Washington this year.

SCHOOL FINANCE EQUALIZATION

The Statewide Property Tax: "I guess what I'm doing is running a flag up to see if we can get anybody to salute it." With this comment, Texas Senator Carl Parker, chairman of the Senate's Education Committee, presented a legislative package including a statewide property tax as high as 1% of assessed value. Enactment in Texas, which would require a constitutional amendment to eliminate the constitutional prohibition of state property taxes, isn't likely. But the concept of the legislation underlies many of the court decisions in the school finance equalization cases and illustrates the difficulties legislatures face in dealing with such cases.

In every state, there is wide variation among school districts in the property tax base for schools, measured by assessed value per pupil. As a result, equal tax efforts, that is, equal property tax rates, will provide unequal funding per pupil. If districts try for nearly equal results, they produce highly unequal taxes. For example, the richest district in Texas has a rate of about 0.25% of value while the poorest has a rate of 0.9%. Typical state equalization programs can mitigate these differences, but not eliminate them without prohibitive cost. The Texas program, adopted after numerous special sessions and a tax increase in 1990, mitigates them. As a result, the poor districts are back in court seeking more equalization. They have won at the lower court level and Parker sees little hope that the state supreme court will uphold the legislation he sponsored last year.

The statewide property tax eliminates the problem of disparate wealth per pupil by putting all the state's property tax base behind all of the pupils, providing equal wealth per pupil for all pupils. But if there is no local option to increase the rate, then local voters couldn't provide more school spending even if they choose to do so. To avoid this, Parker's proposal leaves room for a local option property tax on top of the state tax. Unfortunately, such a local option reintroduces disparities among districts based on their wealth per pupil. This is one of the reasons why state legislatures have such difficulty in finding school financing arrangements that they find acceptable that also prove acceptable to courts seeking complete equalization. So, besides Texas, New Jersey also finds itself back in court immediately after having adopted a major equalization plan.

Hawaii uses a statewide tax system for the support of all its schools, so it doesn't have an equalization problem. New Mexico gets to about the same result by mandating a uniform low-rate property tax in every school district. Just about every other state is vulnerable on school finance equalization criteria.

School Finance Cases: School finance cases are active in at least the following states: Alabama, Alaska, Idaho, Illinois, Indiana, Louisiana, Massachusetts, Minnesota, Missouri, Nebraska, New Jersey, North Dakota, Ohio, Oklahoma, Oregon, Tennessee, and Texas. There are probably others.

To prevail in these cases, plaintiffs must fulfill three basic conditions: (1) bringing the litigation through the trial stage and any appeals, (2) convincing the courts that the state constitution requires the state to provide roughly equalized spending in individual school districts, and (3) getting the courts to take action sufficient to require the legislature to act. Not all these conditions will be fulfilled in every state where litigation is a topic.

The decision to undertake litigation on school finance carries some hazards for the litigants. The action is costly to the districts involved. It will often incur the wrath of some of the other school districts and their teachers, as one of the potential results is to reduce state aid that would otherwise be available to them. In the process, it may destroy a united front in dealing with the legislature on school aid allocation issues -- carrying both the risk of lower school funding in total and the risk that the funding made available won't be favorable to the districts in court. The existence of litigation, particularly at the appellate stage, can also provide a rationale for relatively low school aid allocations as the legislature waits for the court's guidelines before infusing substantial new money into the school aid formula. For all these reasons, in some states it appears that districts are in a hurry to establish that litigation is being undertaken, but in no hurry to press for court decisions.

Getting a state court to decide that state constitutions require substantially equal per pupil spending, or equal spending with equal local tax effort, isn't easy either. The U.S. Supreme Court has decided the U.S. Constitution has no such requirement and about half the cases have resulted in comparable state court decisions. In the typical case, plaintiffs are trying to convince a state court that constitutional language to the effect that the state shall ensure that there be a system of free public education carries an equalization mandate. In Alabama's case, the problem is even more difficult as the language regarding the state's obligation to provide public education was eliminated from the state constitution at a time when the state was battling desegregation. It has never been reinstated.

Even if a state court system decides a school finance system is inequitable, quick remedies don't necessarily follow. In the Texas case, legislators were convinced (or acted as though they were convinced) that the courts would enjoin the distribution of aid under the old formula, thereby closing many of the state's schools. Some Texas legislators appear to have believed that the court would write its own school aid formula and find a way to require that funds be disbursed pursuant to it. But in West Virginia, it has been clear that the courts weren't about to attempt either of these remedial actions. The possibility for inaction on remedies are substantial. It typically takes at least a year to litigate a school finance case to final conclusion. During that year, the formula would likely be changed in the normal course of legislative action, creating a potential for a new decision on the merits and a new set of appeals.

Complexities In The Cases: As the courts have become more involved in school finance, the emphasis has shifted from relatively simple views of equalization to more complex arguments over such subjects as measures of need and of local fiscal capacity.

Local fiscal capacity is easily measured by the property tax base per pupil. But some districts, such as high income residential suburbs, may have more discretionary taxpayer income than districts with somewhat higher per pupil property tax bases -- or at least so it can be argued. Another problem arises when two districts have identical property value per pupil, but one shares its tax base with a high tax jurisdiction such as a central city while the other doesn't.

There is endless room for argument over how exactly "need" for education spending should be measured, once the concept that all pupils have identical needs for spending is abandoned. One of the major changes in New Jersey this year involved definitions of students requiring compensatory education. The new program defines "at risk" students by qualification for free school feeding programs, basically an income test that eliminates most suburban children. The old test was related to school performance, so it put considerable quantities of money into the suburban districts.

FINANCING HEALTH CARE

Stalemate In New Jersey: Having failed to resolve health care financing issues in 1990, New Jersey officials will try again in 1991.

> If we are going to cure the ills of the uncompensated care system, we must bring everyone who has something at stake to the table. As the crisis has loomed, we have heard many diverse views of what steps should be taken. The diversity of the views and the complexity of the problem show that a consensus must be reached to address the indigent care system.

With these words, New Jersey Speaker Joseph Doria announced that he had invited over 250 interested parties to a health care summit meeting in early January.

The Major Reform Plan: This fall, New Jersey legislators watched the options shrink from adoption of a health care plan that might set the pace for the nation's states to doing nothing, leaving health finance in limbo effective January 1. Health care had been the one major omission in Governor Florio's package of school finance equalization, tax reform, local government finance, and budget revision that passed earlier this year. The knotty health care problem was left to a Blue Ribbon commission that reported this fall with recommendations to move toward universal coverage. The main financing mechanism was a payroll tax of $144 per employee-year for uncompensated care plus over $1,000 per employee-year for employers who wouldn't provide minimum health care coverage for their employees.

Tax-shy legislators balked at the tax aspects of the plan. So did the state's major business organizations, despite the enthusiastic support of some of the business leaders who had served on the commission. Business groups argued that something should be done about cost controls before adopting a new financing plan. The state AFL-CIO has continued to press for the commission recommendations.

Stop-Gap Measures: Absent action on a new plan, the obvious choice was to renew the current Uncompensated Care Trust Fund beyond its scheduled expiration at the end of 1990. The fund gets its money from a surcharge of 19% on hospital bills. The rate would have gone to about 23% in 1991. The Senate voted to extend the fund for three months. But the House adjourned without action, a decision concurred in by Governor Florio. He called the current system "woefully out of control" and argued that it was better to "start the process of taking some action" than to preserve a system that hadn't worked. The financing of the Trust Fund is also under attack in New Jersey courts by the AFL-CIO and Blue Cross/Blue Shield. They contend the 19% surcharge is a tax and, as such, was invalidly enacted because the legislation originated in the Senate, contrary to a state constitutional provision requiring tax legislation to originate in the House.

The AFL-CIO is looking for support from state and local officials. It estimates they now have health insurance plans costing an average of $3,374 for each of 687,000 active and retired workers, for a total health tab of $2.3 billion annually. The argument is that broader coverage of private employees would cut the costs of uncompensated care now buried in the bills of those who are covered. However, to make the concept work, additional public financing would also be required by an extension of Medicaid and tax incentives for employers adopting health plans.

What happens if the Trust Fund isn't extended? Presumably individual New Jersey hospitals will create their own surcharges for uncompensated care, surcharges that would vary significantly from hospital to hospital. But Medicare and some health insurers wouldn't necessarily agree to pay the surcharges and private patients might well steer away from the hospitals providing the most charity care -- raising the problem of uneven incidence of such care that caused New Jersey and other states to adopt devices that spread uncompensated care costs evenly over all hospitals.

Health Spending: The department of Health and Human Services has concluded that spending on health care reached $604 billion in 1989, about $2,400 per capita. The overall spending increase was 11.1%, bringing health care expenditures to 11.6% of gross national product, a new high. The statistics suggest about half the increasing costs of direct patient care were associated with demographic change (9%) and general inflation (44%). The rest of the increase resulted from higher inflation in health costs than other costs (21%), and greater utilization of health care services (26%).

Health Care Costs By State: Estimates of the differing per capita health care costs (private and public) by state appear in Table 7.

Table 7: Estimated Per Capita Spending For Health Care, 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Massachusetts	$3,031	18	Maryland	$2,436	34	Maine	$2,175
2	California	2,894	19	Florida	2,427	35	Oklahoma	2,139
3	New York	2,818		**United States**	**2,425**	36	West Virginia	2,088
4	Nevada	2,757	20	Colorado	2,415	37	Virginia	2,076
5	Rhode Island	2,707	21	Alaska	2,367	38	Georgia	2,072
6	Connecticut	2,699	22	Iowa	2,351	39	Montana	2,059
7	North Dakota	2,661	23	South Dakota	2,322	40	New Hampshire	1,981
8	Illinois	2,619	24	Oregon	2,312	41	Vermont	1,956
9	Michigan	2,569	25	Washington	2,311	42	Arkansas	1,944
10	Missouri	2,568	26	Alabama	2,286	43	Kentucky	1,875
11	Kansas	2,548	27	Delaware	2,268	44	North Carolina	1,833
12	Pennsylvania	2,536	28	Tennessee	2,262	45	New Mexico	1,792
13	Ohio	2,493	29	New Jersey	2,224	46	Utah	1,784
14	Minnesota	2,480	30	Arizona	2,211	47	Wyoming	1,756
15	Hawaii	2,469	31	Indiana	2,201	48	Mississippi	1,751
16	Nebraska	2,452	32	Texas	2,192	49	Idaho	1,726
17	Wisconsin	2,449	33	Louisiana	2,185	50	South Carolina	1,689

While there is a substantial amount of guesswork in both the national totals and the state-by-state breakdowns, the differences among the states have the characteristics that would be expected. Other things being equal, states with higher per capita incomes tend to have higher per capita spending on health care. Other things being equal, health care spending tends to be an increasing function of age. So the leading states tend to have disproportionately elderly populations, like North Dakota, or high per capita incomes, like Connecticut and New Jersey. The states with the lowest spending tend to have low per capita incomes and a relatively low median age.

Medicaid Costs: There are many different ways to view the Medicaid costs of individual states. Table 8 reflects several different concepts. The rankings and the first column show total (federal, state, and local) Medicaid spending per capita in FY 1989. That total spending is shown in column three (in billions) and per Medicaid recipient in column two. The final column shows the estimated FY 1990 share of total health care costs in the state paid by the state and local (but not federal) Medicaid spending. The states shown are the top ten in Medicaid spending per capita plus all other states where total Medicaid spending was a billion or more in FY 1989.

Table 8: Dimensions of Medicaid Spending, Selected Years And States

Rank	State	Per Capita ($)	Per Recipient ($)	Total ($ million)	Percent of State Health Spending
1	New York	$568	$4,522	$10.2	10.5%
2	Massachusetts	405	4,109	2.4	6.9
3	Rhode Island	375	3,634	0.4	6.4
4	Connecticut	317	4,501	1.0	5.8
5	Maine	304	3,030	0.4	4.8
6	North Dakota	270	3,832	0.2	5.0
7	Minnesota	254	3,426	1.1	6.1
8	New Jersey	248	3,602	1.9	6.0
9	Ohio	244	2,351	2.7	4.6
10	Louisiana	236	1,967	1.0	3.6
13	Wisconsin	230	2,784	1.1	4.4
	United States	**219**	**2,318**	**54.5**	**4.5**
15	Michigan	211	1,794	2.0	4.2
16	Indiana	207	3,703	1.2	3.9
17	Pennsylvania	204	2,233	2.4	4.1
25	Georgia	190	2,108	1.2	3.6
26	California	189	1,653	5.5	4.2
29	Illinois	180	2,106	2.1	4.0
30	North Carolina	177	2,390	1.2	3.1
39	Florida	151	2,184	1.9	2.8
45	Texas	131	1,878	2.2	3.1

State Responses To Cost Pressures: HealthWeek (12/17) interviewed some of the nation's leading health figures on the outlook for health policy in 1991. One of those interviewed was Ray Hanley -- the Arkansas Medicaid Director serving as chairman of the American Association of Medicaid Directors. He noted the pressures of lawsuits by health care providers over reimbursement rates, new federal mandates, and other factors increasing costs, and concluded:

> The prohibition against deficit spending in most states, coupled with the pressures already detailed, dictate hard choices if provider reimbursement is raised substantially to settle or avoid legal action.
>
> For example, optional programs must be curtailed or eliminated -- primarily in services for adults. In Arkansas, we recently eliminated our medically needy adult program. Now, providers receive no payment when serving these people. We also suspended coverage for several adult services, including dental and psychologist services.

In addition, states will be unable to fund optional Medicaid expansions, such as 185% poverty coverage for pregnant women.

Oregon's Health Plan: While Oregon's plan for dealing with Medicaid has attracted national attention, it is now several years behind its original schedule and no where near a stage that could be copied by other states.

The essence of the plan is to prioritize the health services offered under Medicaid, skipping some less significant expensive services for a few so that available dollars can provide more services for more people. The first step is developing a priority list. A draft released in May was withdrawn with a new list promised successively for the summer of 1990, the fall of 1990 and now March of 1991. Then the legislature must act to approve both the listing and an associated Medicaid budget. Then a waiver of Medicaid regulations must be obtained from the federal government, a process expected to start in July and end around the end of 1991. Neither legislative nor federal approval can be presumed.

FEDERAL IMPACTS ON STATES

Introduction: In releasing NCSL's survey of legislative leaders' priorities, NCSL President John Martin (Maine's Speaker) discussed what he called "a significant and growing concern to state legislative leaders" -- federal decisions affecting states. While recognizing the role of other factors contributing to state fiscal problems, he commented, "more and more legislative leaders are identifying the federal government as a major factor." Why: "As is clear from the last budget agreement, Washington's solution to its inability to deal with the federal deficit is to transfer the problem to state governments."

State officials see problems appearing in each session of Congress through the combined impacts of: (1) restrictions on the deductibility of state and local taxes, (2) limits on tax-exempt financing, (3) reductions in grant programs, and (4) unfunded mandates. The basic concern is that federal officials will respond to tight fiscal circumstances by cutting direct and indirect support of state finances and simultaneously respond to the need for action on domestic priorities by mandating state and local action without funding the mandates. Assessing the situation from a federal perspective suggests all these fears are based in reality.

Federal "Subsidy" Of State And Local Government: Much federal staff work views the federal government as aiding state and local governments in three ways: (1) the deductibility of certain state and local taxes (primarily real property and income) from income subject to federal tax, (2) the "subsidy" inherent in permitting issuance of tax-exempt bonds which, because interest isn't subject to federal tax, have lower interest costs than corporate bonds or even federal bonds, and (3) grants.

Many state and local officials reject this formulation -- arguing that deductibility and tax-exempt bond authority have their basis in conceptions of federalism and therefore aren't of the same character as decisions on budgeted grant programs.

But as they consider ways to reduce the federal deficit, the President and Members of Congress are constantly confronted with tables and option papers which treat tax-exempts, deductibility, and grants on an equal basis. Each of these "subsidies" has a cost, which is measured annually in the federal budget documents and various special reports such as those issued by the Congressional Budget Office. The cost of grants is a regular budget outlay. The costs of deductibility and tax-exempts are "tax expenditures."

Assessing Deductibility And Tax Exempts: The deductibility of state and local taxes and, even with restrictions, tax-exempt bond issuance authority involve considerably less federal control over how state and local officials use resources than grant programs, except general revenue sharing. From a perspective that the federal government ought to control carefully the priorities associated with use of its scarce resources applied by state and local officials, broad subsidies of tax-exempts, deductibility, and general revenue sharing are all to be avoided. This perspective constantly finds its way to the table in federal budget balancing discussions. For example, in a recent book (see below), Dennis Zimmerman (Congressional Research Service) concludes: "Tax-exempt bonds and state and local tax deductibility are, in effect, the equivalent of open-ended matching grants for the entire spectrum of state and local services." He notes that with tax-exempts, deductibility, and open-ended grants, "the federal government loses its ability to control its budget."

Limits On Deductibility: The history of federal income tax law over the last 20 years is one of a continuing reduction of the extent to which taxes paid to state and local governments are deductible from income subject to federal tax.

Past actions removed the deductibility of motor fuel and sales taxes. The 1990 legislation has a complex provision which reduces deductibility for taxpayers with incomes over $100,000. In its Federal Update (11/2), NCSL commented the provision "poses a major threat to state fiscal systems and is likely to be revisited as a source of increased federal revenues."

Tax-Exempt Bonds: State and local governments are now operating under substantial constraints on their ability to issue bonds with interest exempt from federal income taxes. The use of these bonds, particularly for financing activities in the private sector, have been under continuous attack in the Congress as: (1) distorting private sector incentives, (2) eroding the federal tax base, and (3) reducing the progressivity of the federal tax system by providing a haven for the rich to earn interest without paying taxes. As a result, complex regulations govern "arbitrage" (borrowing tax-exempt and lending taxable), there are restrictions on the form of bond issues (e.g., eliminating bearer bonds), and significant caps on the volume of certain issues.

Dennis Zimmerman (Congressional Research Service) traces two decades of history and examines the many policy issues involved in a new book, The Private Use of Tax Exempt Bonds (Urban Institute Press, 1991). Because of the possibility of abuse of unlimited authority to issue tax-exempts, Zimmerman believes there must be some limits set by the Congress, while leaving room for tax-exempt financing of public projects like schools and roads. Doing this hasn't been easy:

> To develop effective legislation has been and remains extraordinarily difficult. Each major piece of tax legislation since 1980 has changed the tax-exempt bond rules in an atmosphere of intense lobbying by representatives of state and local governments. Administrations have usually urged Congress to tighten the rules. Representatives of the investment bankers and bond counsel whose livelihoods are determined by the volume of issuance enter into the legislative fray in a predictable but understandable way. The compromises reached have accomplished some federal objectives, but at the expense of significantly complicating the legitimate fiscal activities of state and local governments. Beyond the frustration of coping with ever-changing rules, state and local officials express genuine philosophical concern about whether the new rules conform to their understanding of traditional concepts of American federalism.

Zimmerman's book is a definitive background piece which will likely become the standard source for both the history of the issue and the arguments in use on all sides. Zimmerman sees the logical result as elimination of tax-exempt financing for small-issue industrial development bonds, single-family housing, student loans, and more. Given the resulting restriction of purpose, he suggests there could be some relaxation of other controls. This issue arose in the 1990 deficit reduction legislation because provisions authorizing certain tax-exempt bonds were due to expire. In some of the compromise versions, they were not continued. But they were continued in the version that ultimately passed, but only for 15 months -- guaranteeing the issues will be back.

Grants: So long as there is a perceived federal deficit problem, there will be considerable pressure to reduce amounts provided to state and local governments as grants, particularly outside the grant entitlements like AFDC and Medicaid. The complex provisions of the new budget reduction legislation will force grant allocations into competition with spending pressures for direct federal domestic outlays. NCSL (Federal Update, 11/29) summarizes the provisions as follows:

> The impact of these spending limits will likely force federal aid programs for state and local governments to compete directly with other pressing budgetary priorities. More important, because the federal government will have less money to launch new domestic initiatives, states can expect a heavy reliance on unfunded federal mandates.

Mandates: Members of Congress continue to campaign on the basis of improvements they will help to produce in American society. They are unlikely to find that continuing national defense expenditures, the existing Social Security and other entitlement programs, and paying interest on the national debt will fulfill any aspirations they have for improvements in areas such as education, health, housing, pollution control, and transportation. With no fiscal room for new grant programs, this leaves unfunded mandates as the only road to apparent national progress through federal action.

This perspective on likely federal policy is widely shared among state officials. For example, NCSL's detailed assessment of the federal budget compromise (by Martha Fabricius and Christopher Zimmerman) commented that the agreement's requirements that grants compete for growth money with direct federal outlays mean "states can expect the decline of the last decade in the federal share of joint programs to continue." They continue, "Congress will apparently have relatively little room for new initiatives over the next five years. This makes it more likely than ever before that any new initiatives will rely heavily upon unfunded mandates imposed upon the states."

Will The Pressures Abate? There is widespread skepticism that the federal deficit-reduction agreement will produce deficits as low as the enacted targets. The comments in Business Week (11/5) are typical, except that they highlight the National Association of State Budget Officers rather than other forecasters. NASBO is quoted as using a projection of $250 billion for the deficit in FY 1995 -- about the current deficit and a far cry from the $63 billion in the law's projections. This would take the total federal debt to over $4.5 trillion by FY 1995. As debt rises, so does the interest bill. In FY 1992, interest alone will be nearly $1,000 per capita, putting greater pressure on federal officials to raise taxes or cut spending.

REVITALIZING THE ILLINOIS ECONOMY

Introduction: Illinois economic performance isn't anything to write home about. While national manufacturing employment remained about constant over two decades, the state lost about a quarter of its manufacturing jobs. If the state's growth had matched the national average in the 1970s and 1980s, there would be 1.5 million more people employed than now have jobs. Arguably, the state has been in an economic ice age -- ripe for the 355-page book with solutions, Coming Out Of The Ice: A Plan To Make The 1990s Illinois' Decade (Joseph and Diane Bast, eds., Heartland Institute, 634 S. Wabash Ave., Chicago, IL 60605).

The publication appears to be the most ambitious effort of the Heartland Institute. The Institute, organized as a not-for-profit corporation, is oriented toward dealing with state and local issues in the Midwest. It has previously published studies on such issues as the Midwestern business climate, subsidies of sports stadiums, privatization, tax abatements, Wisconsin's tax climate, and deregulation in transportation. The organization's substantial publications list and professionally published materials indicate that its combination of business and individual sponsors provide considerable support. Its Illinois publication is endorsed by the head of the Illinois Manufacturers' Association and several legislators. But the group certainly isn't "establishment." Its brochure advertising Coming Out Of The Ice features a picture of long-time Illinois Governor Thompson (R) with this quote: "I don't pay much attention to The Heartland Institute, and I don't think voters across Illinois will pay much attention to them either."

While the policy recommendations are for Illinois, their logic suggests they would be applicable to all states. Illinois doesn't have exceptional state policies. Its taxes are about average by all measures. So are its spending levels and patterns.

Taxes And Economic Growth: The book argues, "The most important single step Illinois can take to increase its economic growth rate is to cut state and local taxes." For the state, this implies letting the 1989 temporary tax increase expire. This is the same increase that was a major issue in the 1990 gubernatorial campaign which Governor-elect Edgar won despite (or because of) his endorsement of renewal. Without the surcharge, the flat rate income tax would be 2.5%, which Heartland says Illinois should drop to 1.5% while taking the corporate rate to 2.4%. In addition, the group wants "significant property tax relief, perhaps by requiring public referenda on any year-to-year increase in property taxes." To support the tax cut recommendations, the group relies on an extensive canvass of the literature on the relationship between taxes and economic growth and a small contribution of its own to this literature.

As often noted, there is room for argument over what can be concluded about the tie between taxes and growth. Coming Out Of The Ice will provide a convenient compilation for those seeking support for the argument that taxes make a major difference.

Providing Public Services: The lengthy discussion of providing public services is heavily oriented to privatization -- continued public responsibility for seeing that services are provided but looking to private contractors as providers of services.

In education, this means a heavy orientation toward choice plans, including a version of tuition tax credits that would work with rebates of school property taxes. The private sector is also seen as the salvation of transit systems and capable of contributing some new road construction. User fees placing more responsibility on heavy trucks are recommended. In corrections, Heartland recommends several policies designed to reduce prison populations: (1) community alternatives such as electronic monitoring, (2) cheaper facilities such as dormitory-type facilities for drunken drivers, (3) community service and other alternative sentences, (4) taking prison capacity into account in sentencing, and (5) possible decriminalization of drugs. In welfare, the group proposes emulating some of Wisconsin's requirements for eligibility and linking welfare eligibility to work. It also likes channeling more support for the poor through the tax system (e.g., greater deductions for dependents) and less through government welfare agencies.

While the book's recommendations on both taxes and spending are interesting, they aren't consistent. Even if Illinois adopted all the spending recommendations, it couldn't afford to adopt the tax recommendations.

Regulatory Reform: The regulatory reform recommendations generally call for reductions in state and local requirements -- occupational licensing laws, building codes, minimum wages, and bank regulation.

MISCELLANY

State Fiscal Conditions: Half the states are experiencing revenues that are 1% or more below their original revenue estimates according to a December assessment by the National Conference of State Legislatures. Only ten states reported their revenues were 1% or more above estimates. These were states favorably affected by higher oil prices -- Alaska, Louisiana, North Dakota, and Texas -- plus other states west of the Mississippi River -- Arkansas, Hawaii, Idaho, Nebraska, Utah, and Washington. Fifteen states reported revenues within one percent of the estimates on which their budgets were based.

The combination of revenue deficiencies and spending exceeding estimates produced potential shortfalls in 27 of the states surveyed by NCSL. In most of these states, the shortfall will be handled by combinations of spending cuts, revenue increases, deferrals of spending, acceleration of revenues, and intra-fund borrowings, so shortfalls won't appear in the year-end results. However, some states will report deficits. While 49 states have balanced budget requirements, some of those requirements are for enactment of a balanced budget but do not prohibit shortfalls in a budget viewed as balanced when enacted.

Most of the shortfalls indicated by the survey were less than 4%. While serious, such shortfalls are conceivably capable of being handled without tax increases or massive spending cuts. But some states reported much larger shortfalls -- Michigan (12.0%), Rhode Island (8.7%), Connecticut (7.7%), Missouri (7.5%), Vermont (7.4%), Florida (7.2%), New Hampshire (7.0%), Maine (6.2%), Georgia (4.4%), and Delaware (4.2%). These shortfalls not only present a serious FY 1991 problem, they are so large that they make it extremely unlikely that FY 1992 could be balanced without tax increases or truly major spending cuts.

The final version of the survey, The State Fiscal Outlook For 1991, was scheduled for release at the NCSL Fiscal Chairs seminar in early January. State officials have been revising their estimates frequently as new data becomes available on actual revenue collections and national economic statistics and forecasts become more dismal. So the individual state results cited above will be obsolete by the time readers have occasion to use them.

Legislative Priorities: NCSL has issued a survey of state legislative leaders, Top Priorities For State Legislatures In 1991. The first priority, state finances and taxes, is no surprise. Education placed second with the environment third. There are also many process issues on the legislative agenda including reapportionment, campaign finance, and ethics.

TECHNICAL NOTES

Welfare Reform; The state scores appear in Children 1990: A Report Card, Briefing Book, and Action Primer (Children's Defense Fund, 1990). State policy issues associated with children in special situations (e.g., homeless, born addicted to drugs) are the subject of the June issue of State Government News.

Corrections: The data on prisoners, probationers, and parolees are kept by the U.S. Department of Justice, Bureau of Justice Statistics. The state statistics include a small number of federal prisoners. Probation is generally an alternative to a prison sentence. Parole occurs after a prison sentence, by way of reduction of the time to be served in prison. The New York study comes from the Office of the State Comptroller (Alfred E. Smith State Office Building, Albany, NY 12236).

The alternatives to prison sentences, such as community corrections programs, are discussed in the lead article of **Reports**, Vol. 7, Issue 22 (November 1989).

School Finance Equalization: For a discussion of the complexities of school finance revision in New Jersey, see New Jersey Reporter (June/July). On the reasons why similar measures haven't passed in New York and the possibility of litigation there, see Empire State Report (August). The Texas debates resulted in two useful reports from the House Research Organization (P.O. Box 2910, Austin, TX 78769), An Introduction To School Finance and Wrap-Up Of The 1990 Special Sessions On Public Education. An 83-page report by the Tennessee Advisory Commission on Intergovernmental Relations (226 Capitol Blvd., Nashville, TN 37219) is informative at two levels. Fiscal Capacity Of Public School Systems offers technicians an excellent example of applying the concept of a representative tax system, pioneered by the U.S. Advisory Commission for states, to the local level. To non-technicians, it is illustrative of the complexities that can be involved in court consideration of school finance equalization decrees.

Health Care: The state-by-state costs of health care were calculated by Lewin/ICF for presentation in a report by Families USA Foundation (1334 G St., NW, Washington, DC 20005). The report, EMERGENCY! Rising Health Costs In America, was issued in October 1990. Statistical tables include projections of cost by state for the year 2000, an estimate of the uninsured population, the health care costs picked up on Table 7, and the components of health care costs including the Medicaid share which is included in Table 8. The other data in Table 8 are from the federal Health Care Financing Administration via the New York State Comptroller (A. E. Smith State Office Bldg., Albany, NY 12236) who used the data for all 50 states to further his argument that New York's nation-leading Medicaid costs should be reduced.

Federal Impacts: The concerns over federal mandates are reported almost constantly in articles like "Those Maddening Mandates," State Government News (12/90). NCSL and other state organizations are trying to make their monitoring of potential mandates more systematic as a way to prevent federal officials from imposing more of them. The "Mandate Monitor" is described in The Fiscal Letter (Nov./Dec. 1990).

The monitoring of mandates resulted in a count of "at least 20" additional mandates imposed on the states in the 101st Congress. This includes substantial mandating in the Clean Air legislation along with the many mandates in the budget-balancing legislation and other bills.

It is nearly impossible for any state to track costs associated with federal mandates because cost-driving events don't come labeled as mandates, even if that is their origin. They may appear as federal regulations. They may appear as state regulations or state laws without separate labels indicating they are responding to mandates rather than the best judgment of those adopting them. They may appear as court decisions, as consent decrees, or as agency policy adopted to avoid feared litigation.

An internal memorandum of Michigan's budget agency (Department of Management and Budget, P.O. Box 30026, Lansing, MI 48909, "The Judicial Impact On the Michigan Budget," 8/23/90) provides a seven page listing of litigation with budget impact. Some items (and fiscal impact if resolved unfavorably to state): hospital reimbursement under the federal Boren Amendment ($50 million), consent decrees for corrections ($17 million), mental health facilities layoff procedures ($20 million, one-time), mental hospitals consent decree ($11 million), adult foster care facilities reimbursement rates (unknown), certification of beds in private nursing homes (up to $100 million, one-time), and an old school desegregation case ($4 million). There is also a listing of national cases with implications for Michigan.

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The optimism that state governments alone offer the solutions to nearly every problem has been cooled by fiscal realities and the continuing federal mandates of state spending.

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January 1991 (Second of Two January Issues)

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ECONOMIC DEVELOPMENT STRATEGIES

Introduction: The immediate attention of most state elected officials is now drawn to budget-balancing. This forces attention on unpopular choices -- cutting programs and raising taxes. But officials will be looking for more popular things to do, such as stimulating economic growth. At the same time, concerns of the unemployed and underemployed will become more pressing. Many of the unemployed can't easily be -- indeed don't want to be -- reached by traditional state programs. What they really want is a job, not welfare or job training or any other state program. Their need to earn income is shared by their state, as state economic growth provides the fiscal room to continue and enhance programs without tax increases.

If past patterns are any indication, concern will soon move to state policies to promote economic development. In this context, it is relevant to ask several questions. First, what strategies have proven popular among state officials? Second, what programs are being pursued now? And third, what is known about what strategies and programs have proven effective in the past?

Multiple Strategies: There is a considerable debate between "old" economic development strategy and "new" economic development strategy. For opponents, the old strategy is "smokestack chasing." For proponents, it is aggressive marketing of the state's assets and attempts to maintain a reasonable business climate. For opponents, the "new" strategy is an inherently futile, wasteful, and unfair attempt to "pick winners" among private firms and industries and a new way to rationalize spending on traditional government activity like education, public works ("infrastructure"), and even social welfare. For proponents, the new strategy targets state resources to the areas of a state's comparative advantage and invests state resources in what government does best, particularly education. These debates are more often found in academic and journalistic assessments of state policies than in actual state policy debate.

While a case can be made that some states are leaning toward one view more than another, practically every state pursues some elements associated with each of these strategies. The disputes about what best promotes development has encouraged states to cover all the bases.

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Indiana provides an example where a governor who was critical of past development efforts is opting to pursue a strategy that resembles them closely, while Arizona illustrates the pressure to match other state incentive programs. Colorado's recently announced strategy shows the tendency for individual states to adopt all available strategies, rather than picking among them.

Industrial Recruiting, Indiana Style: This fall, Governor Bayh, the Indiana Chamber of Commerce, and CEO's of several Indiana utilities announced a new public-private partnership to recruit business to Indiana. The state's spending for marketing, advertising, and recruiting will be doubled. Top executives will be involved in recruitment. There will be more training of state and local development officials. And, an effort will be made to target particular industries. The governor commented, "The 1990s will prove to be even more competitive than the 1980s proved to be." So, he concluded, "We need to be much more aggressive." A consultant to the state told the press that there was increasing interest by business firms in incentives provided by state and local government.

Considering The Options, Arizona: In October, the 57th "Arizona Town Hall" assembled many of the state's notables to discuss economic development. The conferees recommended a stronger role (and bigger budget) for the state's economic development agency plus one-stop shopping for state permits. The group's report stresses a private-public partnership for development. The conferees argued over the value of providing incentives for individual firms. The group's written report commented, "So long as other states offer tax incentives for economic development, it appears that Arizona may have to do the same." The group's definition of when incentives would be appropriate would probably command acceptance anywhere, but offers considerable room for interpretation:

> Before any incentive is implemented, there should be a careful weighing of its costs and benefits. The costs and returns from the incentive must be quantified to assure that there is a positive economic return and benefit to the state and community as a whole. In short, only those incentives should be implemented that represent sound investments.

The Third Wave: Yet another approach, a "third wave," is offered to state policymakers by Doug Ross and Robert Friedman in The Entrepreneurial Economy Review. The authors suggest several deficiencies with second wave programs: (1) insufficient scale of activities, (2) fragmented service, (3) lack of accountability, and (4) little link between economic and social concerns. The third wave abandons the approach that government agencies should do everything in favor of more favorable organizational approaches. The examples of activities involve significant private sector investment, "demand-driven" activities, and competition. The vanguards are offered as:

(1) the Michigan Strategic Fund, which tries to encourage formation of private financial institutions, (2) Minnesota's education choice program, and (3) the North Carolina Rural Economic Development Center, which emphasizes technical assistance and training rather than grants for rural areas.

Development Strategy In Action, Colorado: Colorado was one of the Western states suffering serious economic problems in the mid-1980s as a result of a decline in resource prices and other factors. The state's response has included an extensive economic development effort, including development planning that culminated with the publication of Colorado's Five Year Economic Development Strategic Plan last summer. The plan reflects a private-public partnership, including many steps taken by legislation as well as by action in the executive branch. It doesn't leave many stones unturned. The report of nearly 200 pages discusses 36 specific initiatives in education, 42 in jobs, 25 for rural communities, 22 related to the environment, and 13 for infrastructure.

Colorado hasn't rejected head-to-head competition for location of facilities. The executive summary boasts:

> ... the state has been successful in winning the bid for the US WEST Research Center, Cable Labs, Wal-Mart's new distribution center, the new Nordstrom's department store and credit card operation, and expanded offices for Merrill Lynch and American Express. We have not won all the bids that Colorado has competed for, but we have accomplished our goal of being viewed as a contender for major business enterprises.

Colorado hasn't been reluctant to enter national competitions for facility locations including the supercollider, Sears, Sematec, and the United Airlines and Smithsonian facilities discussed below.

Recruiting and other activities haven't been neglected either. The economic development functions have been reorganized, the governor is an active business recruiter, tourist board activities have been expanded, there are new state offices in Japan and Taiwan, and a seal of quality is now offered for state apple growers. There have also been tax changes, including revising truck taxes, avoiding the move of many states to telecommunications taxes, reducing the severance tax on coal and molybdenum, creating enterprise zones, and adding a tax credit for new coal sales. The state has also sought to reduce regulations affecting business, such as an effort to streamline mining regulation. Reducing Workers' Compensation costs is also a "key initiative."

While Colorado exhibits a substantial commitment to "first wave" economic development strategies, there is also a commitment to what might be called "second wave" and "third wave" strategies. The Colorado plan doesn't make a distinction in terms of waves. Instead, it recognizes: (1) business development programs, (2) community development programs, and (3) "foundation" programs such as education, environmental protection, and infrastructure. The plan sees all three as "intertwined."

Colorado also maintains many programs to assist business including financing, technology transfer, research and development, job training, small business assistance, and more. Besides the state's marketing, business climate, and business assistance programs, the plan has a full platter of policies for dealing with elementary and secondary education, higher education, job training, pollution control, recreation, water supply, transit, telecommunications, and air transportation, including the new Denver airport.

The Outlook: During the late 1980s, practically every state was experiencing enough prosperity so that: (1) current state services could be continued without tax increases and (2) the overwhelming majority of voters had jobs or had reasonable prospects of finding ones in their chosen fields. These two conditions were considerably different from those experienced in the 1980-81 and 1982-83 recessionary periods. With a lag, states tended to respond to the earlier recessionary conditions with new efforts to do something about job creation, above and beyond their then traditional economic development policies. It would not be surprising to see a revival of interest in economic development strategies as the economic pressures on both state citizens and state budgets become more widespread.

ECONOMIC DEVELOPMENT PROGRAMS

Counting Development Programs: Keeping track of the separate economic development programs of the 50 states has become a formidable task. Conway Data tries every year with a series of matrices of states and programs in Site Selection. The latest (October) lists 18 different kinds of financial assistance for industry, 15 forms of tax incentives, 18 kinds of special services for industrial development such as free land and export promotion programs, and ten state incentives for pollution control. With 61 programs and 50 states, the tables have over 3,000 entries, not including extensive footnotes.

Even such a comprehensive inventory cannot capture the richness of industrial development incentives. It excludes the many local programs. It doesn't include special programs in enterprise zones (see below). It indicates whether individual states have individual programs, but doesn't provide details on the programs. They vary considerably in eligibility requirements, funds available, and their perceived usefulness to those locating new facilities.

Development Agencies And Marketing Efforts: There is no precise count of the many state and local agencies devoted to promoting economic development, in part because many of them have multiple purposes as is the case with a local chamber of commerce or state development agency. In one of the latest texts on development (Economic Development Programs For Cities, Counties And Towns, Praeger, 1990), John Levy (Virginia Polytechnic) makes an educated guess. He counts 15,000 to 18,000 organizations devoted to promotion of local economic growth. He calculates that this high number would imply operating costs of these agencies to be in the neighborhood of $4 billion a year. To this figure would be added state outlays for all economic development purposes, local outlays for industrial parks and other projects, federal "tax expenditures" for industrial development bonds, and federal outlays for economic development programs.

Enterprise Zones: Some state governments are continuing to emphasize enterprise zones, even though the original impetus for state action was anticipating a federal program thought likely to pass in the early 1980s that never has been implemented. The states typically designate zones based on criteria of economic hardship such as unemployment and/or low income. Companies that expand employment in a zone are given tax incentives and/or capital financing. In a few states, public infrastructure investments are also targeted for the zones. Conway's inventory (see above) has a supplement detailing 15 different policies states pursue for their enterprise zones. Most of the zone incentives are forms of tax incentives. A rough idea of how intensively the states with zone programs have been supporting them is indicated by Table 1, which shows the number of the possible 15 in effect in each state that uses zones.

Table 1: Number of Enterprise Zone Incentives, 1990

State	Incentives	State	Incentives	State	Incentives
California	11	Missouri	6	Michigan	3
Indiana	9	Vermont	5	Mississippi	3
Illinois	8	Alabama	4	New York	3
Kansas	8	Delaware	4	Ohio	3
Maryland	8	Nevada	4	Tennessee	3
Connecticut	7	Texas	4	Virginia	3
Florida	7	Utah	4	West Virginia	2
Louisiana	7	Arkansas	3	Arizona	1
Minnesota	7	Colorado	3	Georgia	1
New Jersey	7	Kentucky	3	Hawaii	1
Wisconsin	7	Maine	3		

Enterprise zones continue to get mixed reviews among policy analysts (see Technical Notes). The states are making modifications in zone programs as they gain experience with them. For example, this year Tennessee converted from tax credits to reimbursements that are subject to the availability of appropriations.

High Tech Incentives: The number of states with special incentives to promote high technology business has been growing rapidly. A spring 1990 survey reviewed the states with each of nine incentives. Every state reported that it made university R&D facilities available to industry. Entrepreneurial assistance was provided to high-tech companies by all but one state, while technology transfer centers or other activities were provided by all but two states. State science or technological advisory councils exist in all but nine states. There is also substantial grant and tax exemption money available in the form of tax exemptions for R&D (30 states), venture capital (31 states), R&D grants (37 states), incubators (33), and state funds for research parks (24). All told the survey listed nine polices a state could follow. Most of the larger states were pursuing all nine approaches. The other states appear on Table 2.

Table 2: Number Of State High Tech Initiatives, Nine Possible
NOTE: States Not Shown Have All Nine Initiatives

State	Number	State	Number	State	Number
Alabama	8	South Dakota	7	Idaho	5
Colorado	8	Virginia	7	Kentucky	5
Maine	8	Arkansas	6	Massachusetts	5
Montana	8	Delaware	6	Texas	5
Ohio	8	Hawaii	6	Washington	5
Oklahoma	8	Minnesota	6	West Virginia	5
Oregon	8	Mississippi	6	Arizona	4
Utah	8	Nebraska	6	New Hampshire	4
California	7	New Mexico	6	North Dakota	4
Georgia	7	Rhode Island	6	Tennessee	4
Louisiana	7	Vermont	6	Nevada	3
New Jersey	7	Wyoming	6	Alaska	2

Border Wars And Commodity Exchanges: The Wall Street Journal (10/30) called the offers "lucrative even by the standards of recent contests." The prize was the location decision of a group of commodity trading exchanges now located in New York City, with as many as 12,000 jobs at stake. The winner, New York. The price was not disclosed, but the New York Times reported "a construction grant of $82 million, tax and rent subsidies worth $56 million and energy savings of nearly $7 million." One source reported the New Jersey offer as a $100 million capital grant, but New Jersey officials didn't publicize their offer. That state's Commerce Commissioner said after the decision was announced, "We knew all along that the exchanges were really using New Jersey as leverage to get a better deal out of New York."

New Jersey claims continued success in drawing firms from New York. The New Jersey development agency counts 51 announced relocations from New York in 1990, with each one representing an average of 140 jobs. The 1990 count is up from the levels of 1988 and

1989, but down from higher levels claimed in 1986 and 1987. The major relocation decisions in 1990 involved back office operations of financial firms, distribution centers for manufacturers, and relocations of air traffic activities to Newark Airport.

New Jersey And Its Neighbors: The New Jersey tax package which passed last year has stimulated considerable debate about the impact on the state's business climate raising issues of importance in all states.

One school of thought suggests that to the extent business location decisions are sensitive to state and local taxes, they are sensitive to taxes only on the firm. By this criterion, the New Jersey package was a winner. It raised $2.6 billion without touching business -- with the primary increases in the individual income tax and the sales tax. Part of the anticipated effect is lower property taxes providing a significant benefit for businesses, particularly those located in the areas where relief is expected to be greatest such as Newark. In September, the New Jersey Commerce Commissioner suggested the package was helping the state, "If you're a businessman, you look at the bottom line and the bottom line is we didn't increase the corporate business tax in New Jersey."

The other perspective looks at the total tax environment, including taxes on individuals as well as firms. One version looks specifically at the taxes to be paid by the corporate executives who make location decisions. By that criterion, the New Jersey package is much less favorable. It concentrated its income tax increases on high income households, which will also be affected by the sales tax increase. In addition, the redistribution of school aid may cause higher property taxes in the more affluent suburban areas. Although it didn't deal directly with development prospects, a survey by the New Jersey Business and Industry Association shows the governor as having low popularity.

The Commerce Commissioner also suggested the New Jersey package would look better in 1991 than it did in 1990. He pointed out New York and Pennsylvania were waiting until the November 1990 elections to deal with their serious fiscal problems, but predicted when they did, "New Jersey is going to smell like a rose."

Economic Competition Continues: With the economy in the doldrums, there aren't many major economic development plums for states to fight over. But there appears to be hot competition for those available.

The Smithsonian Institution has found that its Air and Space Museum in the District of Columbia won't accommodate the increasing number of aircraft and space vehicles it is acquiring and believes the public wants to see. So it is planning an "annex." The annex, estimated to cost up to $300 million, would hold such attractions as the space shuttle Enterprise and the bomber that dropped the first atomic bomb. The initial competition for the facility was confined to the Washington, DC area. Virginia officials pushed a site at Dulles Airport while Maryland officials urged using the Baltimore airport, which is about as close to Washington as Dulles. The competitors offered free land, tax-exempt bond financing, and other incentives. In early 1990, Smithsonian officials picked Virginia over Maryland and over a proposal from the Denver area that apparently was taken less seriously. The Denver group wants to use Stapleton Airport, which will become surplus when the city's new airport is built. Now, the issue has apparently been reopened because of interest in the Denver site by a key member of the House Appropriations Committee. So Smithsonian officials are taking another look at Denver.

There is much unheralded competition for the location of offices of regional and national organizations. One recent one involved the Southeastern (collegiate athletic) Conference. It will stay in Birmingham for 15 years, shunning Atlanta and other cities that vied for the honor. Its rent, according to press reports, will be $1 a year for a building costing $3 million. The financing will come through the city and its civic center.

Many states are competing for a planned United Airlines maintenance facility that would open in 1993 and eventually have up to 7,000 employees. The leaders are said to be Kentucky (two sites), Oklahoma (also two), and Denver. Other states have expressed an interest, with Virginia's legislature likely to consider legislation this year that would increase its authority to offer incentives.

EVALUATIONS OF DEVELOPMENT PROGRAMS

Introduction: As more state resources go into development programs and more time passes in which past investments can go sour, the criticisms of development efforts have escalated. There has always been academic criticism of development incentives as a "zero sum" game and as giving business interests too much control over state policy. Without assurance that other states would act on the advice, this criticism hasn't much affected state policy. The problem is analogous to someone telling people that trying to get to the head of a line won't improve anyone's position, on average. Of more immediate interest are the criticisms that have developed in campaigns for state office and the evaluations that suggest states might improve their development success by altering the form of their development investments.

Candidates Critical Of Development Efforts: A significant number of candidates have been critical of some of the major state economic development efforts, particularly the large and well-publicized deals for major new plants and other facilities. Neil Hartigan (D, not elected) denounced the Diamond-Star and Sears deals in Illinois. Illinois new Governor Edgar was less critical of those deals, but said they would be less likely in his administration. He urged more investment in worker education and training, rather than in business firms. Governor Joan Finney (D) said in her campaign that she wanted to dismantle several Kansas programs created under the economic initiative fund (with funds from gambling, including the lottery) and consider cutting the Department of Commerce budget. She suggested that a better use of the funds would be in the "Margin of Excellence" program at state universities.

During the Minnesota campaign, then Governor Perpich (D) was consistently criticized on economic development issues. He was closely identified with the Greater Minnesota Corporation which his successful opponent indicated he would modify. There was also criticism of several development investments in Perpich's hometown, including a chopstick factory that closed and a biomedical company accused of fraud in obtaining and using the state subsidy. The new governor, Arne Carlson, has indicated support for the Corporation, but not necessarily its current level of funding. Half of the proceeds of the lottery were originally earmarked for the Corporation, but that has been reduced to 25%.

White Elephants: As time passes, more and more investments of state and local development money prove, in retrospect, to have been mistakes. The results are, at a minimum, politically embarrassing. But in the broad criteria of effectiveness, less than 100% success is not necessarily an indictment of the programs, but it's not an endorsement either. Quantified assessments of state and local investments aren't easy to find.

Some examples of the failures: The Wall Street Journal (11/21) described problems of overconstruction in hotels. The problems, which are likely to become more serious in recession, affect private investments, local use of Community Development Block Grant funds, and local money. In "Iowa Picky About Luring Businesses," the Des Moines Register (7/6) described the state's turning away from meatpacking and telemarketing as a result of getting more choosy about where to put development money. Last summer, North Dakota closed its Japanese trade office and ended its effort to promote an export trading company. Problem: no interest from the Japanese. The states that invested heavily to get the Navy's home port designations are now worrying that their investments may produce white elephants. With threats to the fleet appearing somewhat diminished, the Navy is less interested in decentralizing its fleet to new home ports like Everett (WA), Ingleside (TX), Mobile (AL), Pascagoula (MS), Pensacola (FL), and Staten Island (NY). Wyoming officials have encountered heavy opposition in funding their economic development loan program because one of the early deals was a $1.25 million loan to a company that folded. The state's loans now involve private participation.

There are many examples of failures of horse and dog tracks, though most involve loss of private capital and only public image because the investments were associated with policy changes, like lowering taxes and providing racing days, believed likely to make the track investments feasible. But the investment by Polk County (Iowa) supervisors in a track was viewed as costing several supervisors their jobs in the June primary.

West Virginia's Supercredit: Perhaps the largest single failure of a state development policy is reflected in the fate of the "supercredit" in West Virginia. In 1985, faced with a declining state economy and elected officials intent on doing something about it, West Virginia built on the legislation in other states that provided tax credits for job expansion. But instead of following the pattern of the other laws by providing $500-1,000 for an additional job (sometimes with a requirement that a low-income person get the new job) for a limited number of years with restrictions on the credit not wiping out tax liability, West Virginia's approach was much more expansive. The cost of the credit grew from several million in 1986 to nearly $60 million on 1989 corporate tax returns. Furthermore, coal companies got about 90% of the benefit, even though it had been originally intended for manufacturers, such as GM's Saturn plant. According to one revenue agency study, 20% of the coal mining in West Virginia was occurring without tax liability.

The fundamental problems were twofold -- one intentional and one inadvertent. Both illustrate the problem of the credit approach. The intentional problem was that West Virginia decided on the ultimate in tax relief to encourage business. For job expansion, it basically forgave any liability for any state tax, not just the corporate income tax. The unintentional problem was that the law defined an enterprise as the target when it created jobs, whether or not the jobs replaced other jobs. Coal mining companies were able to eliminate production by one company and replace it with another -- thereby creating eligibility for the second company even though production wasn't expanded.

In 1990, the state reversed its course in part by establishing a "minimum severance tax" on coal. This provided some tax liability even for the companies that avoided old severance tax payments because of the supercredit.

Voters Reject Development Efforts: While voters have approved many development proposals that have appeared on state and local ballots, there are also some significant setbacks. Two examples illustrate some of the citizen concerns.

Louisiana's constitution covers considerable subject matter that is covered by legislation, not constitutional language, in other states. As a result, voters often face long lists of proposed amendments as they did in October when 15 were on the ballot. Of these, 14 passed including budget reform, changing the timing of the legislative session, revising Workers Compensation rules, and permitting tax exemptions for wholesale inventories, historical property, and housing for the homeless. The one which failed would have allowed local governments to donate or loan public money to private businesses to encourage them to move in or expand.

In a July special election, Hoboken (NJ) voters rejected an extensive port development plan previously approved by officials of the Port Authority of New York and New Jersey and city officials. The city will apparently have to pay back a portion of the funds already received.

Infrastructure And Economic Development: In the past several years, there has been considerable interest, particularly by those concerned with highway investments, in academic research appearing to indicate that economic growth is enhanced by investments in public capital (infrastructure). An extensive analysis of this theory appears in an article by Alicia Munnell in the New England Economic Review (Sept./Oct., 1990). Her detailed assessment of state-by-state information on public capital and other factors influencing development concludes that public capital does make a difference in encouraging economic growth. The capital investment that seems to matter is in highways, water, and sewage treatment facilities, not necessarily public buildings or schools. However, she also assessed the impact of overall tax levels, finding that higher taxes had a negative impact on development. The practical conclusion appears to be that a significant advantage will accrue to any state that can find ways to invest in infrastructure without raising taxes.

Assessing Development Programs: The state of the art in assessing the value of state economic development spending is not advanced. As Harry Hatry and his colleagues at the Urban Institute recently put it:

> State and local economic development program managers need to be able to identify the strengths and weaknesses of individual economic development programs as a first step to improving program quality. But assessment of economic outcomes is not a simple task, given the complexity of the economic environment and the lack both of generally accepted performance monitoring procedures and of generally accepted outcome measures.
>
> Many states have experimented in a limited fashion with performance monitoring. Efforts include ad hoc projections of future employment made by businesses

receiving state assistance, accounts of program results and service quality obtained through surveys of clients, and informal, anecdotal information. Such efforts have usually been sporadic, insufficiently comprehensive, unsystematic, or unreliable.

The absence of an agreed way to assess development programs made the debate in the 1990 gubernatorial races less than economically sophisticated. Repeating the logic by which Governor Dukakis obtained credit for the "Massachusetts Miracle," incumbents in states with job gains claimed them as evidence of success of their policies. Using the same logic, opponents stressed job losses. If there weren't job losses overall, they stressed job losses in particular sectors like manufacturing. There were many anecdotal claims and counterclaims based on decisions by firms to locate or expand in a state and, for opponents, decisions to leave for another state.

REASSESSING THE STATE ROLE

The Impotence Of State And Local Government: It may be inevitable that supposedly informed opinion operates in cycles, exaggerating both the good news and the bad news. Inevitable or not, there are signs that this may be happening with the role and possible impacts of state and local government -- oscillating from being the perfect governments to do everything in the late 1980s to largely incapable entities in the 1990s facing responsibilities overwhelming their resources and competence.

The Perfect Governments: The theme of state and local governments as the perfect governments gained considerable support in the 1980s. The theme fit perfectly with the desire of the Reagan Administration to have more decisions made closer to the people and to minimize the federal financial commitment to many domestic programs. It also fit nicely with federal financial circumstances which, after the 1980 tax cut, left a substantial federal deficit as long as major defense spending was continued and the Social Security and related Medicare program weren't cut. The theme suited most state officials, though many local officials were reluctant to see a shrinking federal role.

Problems With The Perfect Governments: There were two major reservations with this image of state and local government, especially state government, as the source of solution to the nation's problems. The first and most significant was that there was no solid indication that state officials would, in an interstate competitive environment, undertake individual state solutions to national problems such as health care. The second was that vast differences in tax base among the states made it inconceivable that states could adopt identical or even closely similar efforts in fields such as education for the disadvantaged. Levels of service that some states could afford others could not without tax levels so far above those of other states as to constitute unreasonable burdens on citizens and threats to economic development.

Helpless States: While these problems have been in existence through the 1980s, they become more apparent in recession, when state budgets appear tighter than they did in the late 1980s. One journalistic reaction is the special report on "States in Distress" that covered two entire pages of the New York Times (12/30) plus a front page story, "80's Leave States And Cities In Need." The basic theme is that the pressures to spend are "enormous," that federal aid defrays a smaller share of state and local costs, and that, "The public is increasingly resistant to new or higher taxes, partly because they believe government is not wisely spending the money."

The article spelled out the scenario for problems at the state level. On the spending side, the emphasis was primarily on prisons and Medicaid, quoting the executive director of the National Governors' Association referring to Medicaid as "the Pac-Man of state government, eating up every dollar." On the revenue side, the article reflected Steven Gold's oft-stated view that economic growth (and thus state revenue growth) would be slower in the 1990s than in the 1980s. It quotes Gold as saying that states do have the option of raising taxes, but at the price of a possible voter reaction in 1992.

A somewhat similar theme is offered by columnist David Broder ("Is This The Year The States Finally Get The Hill's Attention?" Washington Post, 1/6). He cites three facts indicating state problems: (1) the tight budget situation, (2) federal mandates that have "been devastating to state budgets," and (3) a 96% success rate for Members of Congress seeking reelection but losses by six of 23 incumbent governors and changes in party control in 14 of 36 gubernatorial races. He then cites a fourth fact, redistricting of Congressional seats, and suggests state legislators may push for limits on mandates using their redistricting power as a lever. Legislators, he asserts, "will say that they are sick and tired of watching their Washington counterparts take credit for passing all these wonderful-sounding programs and then handing them most of the bills."

The problems of states were emphasized in a National Governors' Association release (1/2) reporting that many states were experiencing revenue shortfalls. The release noted slow revenue growth and rising spending. It continued:

> At the same time, states are feeling increasing pressure to use more of their own limited resources to provide for an expanding array of vital needs -- including health care and safety net programs whose inflationary costs have increased more quickly than state revenue growth, highways and bridges that have to be able to handle increasing traffic, adequate space for skyrocketing prison

> populations, and the education tomorrow's workforce will need to excel in an increasingly competitive economy.

A similar theme appeared from the Federal Reserve (in its Bulletin for December):

> The fiscal position of state and local governments has deteriorated markedly during the past several years, with many governments confronting potential shortfalls in their operating accounts... The last half of the 1980s has seen the financial resources of the states pressured by several concerns: the quality of education and rising school enrollment, the deterioration of the public infrastructure, and mandates to improve the health care of the needy and to upgrade correctional facilities. Over the same period revenue sources have dwindled.

Special Problems Of Cities: The Times assessment is most downbeat on the prospects of major cities, which are described as affected by cuts in federal and state aid, state restrictions on taxing authority, and an increasing concentration of problems in central cities. However, most cities will weather recession considerably better than states. Their revenues, based on user charges for local services and property taxes, are more recession-resistant. Their spending, which for most cities in the U.S. doesn't include welfare or indigent health care, excludes the categories most escalated by economic downturns.

The exceptions are cities which: (1) have county-like functions of welfare and health care, (2) rely significantly on sales and/or income taxes, and (3) are located in the Northeast. Philadelphia has a shortfall of 10% or more of its budget. Its cash crisis is so severe that the mayor has consented to the establishment of a state financial control board. New York has a deficit of as large as $800 million, depending on who does the estimate. The District of Columbia is short some $300 million. It is looking for $100 million more from the federal government as well as layoffs and other austerity measures.

POPULATION STATISTICS

The Census Bureau released its count of 1990 population by state in late December. The results are shown on Table 3.

Table 3: Population Estimates (000) By State, 1990

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	California	29,839	18	Washington	4,888	35	Utah	1,728
2	New York	18,045	19	Maryland	4,799	36	Nebraska	1,585
3	Texas	17,060	20	Minnesota	4,387	37	New Mexico	1,522
4	Florida	13,003	21	Louisiana	4,238	38	Maine	1,233
5	Pennsylvania	11,925	22	Alabama	4,063	39	Nevada	1,206
6	Illinois	11,467	23	Kentucky	3,699	40	Hawaii	1,115
7	Ohio	10,887	24	Arizona	3,678	41	New Hampshire	1,114
8	Michigan	9,329	25	South Carolina	3,506	42	Idaho	1,012
9	New Jersey	7,749	26	Colorado	3,308	43	Rhode Island	1,006
10	North Carolina	6,658	27	Connecticut	3,296	44	Montana	804
11	Georgia	6,508	28	Oklahoma	3,158	45	South Dakota	700
12	Virginia	6,217	29	Oregon	2,854	46	Delaware	669
13	Massachusetts	6,029	30	Iowa	2,787	47	North Dakota	641
14	Indiana	5,564	31	Mississippi	2,586	48	Vermont	565
15	Missouri	5,138	32	Kansas	2,486	49	Alaska	552
16	Wisconsin	4,907	33	Arkansas	2,362	50	Wyoming	456
17	Tennessee	4,897	34	West Virginia	1,802			

The population of the U.S. is highly concentrated in a few states. Three states -- California, New York, and Texas -- account for 26% of the population. The nine largest states account for 52%. The top twenty account for 76%, and the largest 30 for about 90%.

There are some significant changes in the rankings of the states from the rankings in 1980. Florida moved to fourth from seventh -- knocking Pennsylvania, Illinois, and Ohio down a rank to make room for the Sunshine State. Georgia moved from 13th to eleventh and Virginia from 14th to twelfth, kicking Massachusetts and Indiana down. At the bottom, Alaska moved up a notch to 49th, making Wyoming the least populated state.

Changes In Population: The Census Bureau understandably emphasized population change from 1980 to 1990, the two points anchored by an actual count of the population. The changes are shown on Table 4.

Table 4: Percent Change In Population, 1980-1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	50.8%	18	South Carolina	12.3%	34	Arkansas	3.3%
2	Alaska	37.3	19	Vermont	10.6	35	New York	2.8
3	Arizona	35.3		**United States**	**10.2**	36	Mississippi	2.6
4	Florida	33.4	20	Maine	9.6	37	Montana	2.1
5	California	26.1	21	Oregon	8.4	38	Indiana	1.4
6	New Hampshire	21.0	22	Minnesota	7.6	39	South Dakota	1.3
7	Texas	19.9	23	Idaho	7.2	40	Kentucky	1.0
8	Georgia	19.1	24	Tennessee	6.7	41	Nebraska	0.9
9	Washington	18.3	25	Rhode Island	6.2	42	Ohio	0.8
10	Utah	18.3	26	Connecticut	6.0	43	Louisiana	0.8
11	New Mexico	16.8	27	New Jersey	5.2	44	Michigan	0.7
12	Virginia	16.3	28	Kansas	5.1	45	Pennsylvania	0.5
13	Hawaii	15.6	29	Massachusetts	5.1	46	Illinois	0.4
14	Colorado	14.5	30	Missouri	4.5	47	North Dakota	-1.8
15	Maryland	13.8	31	Oklahoma	4.4	48	Wyoming	-3.0
16	North Carolina	13.2	32	Wisconsin	4.3	49	Iowa	-4.3
17	Delaware	12.6	33	Alabama	4.3	50	West Virginia	-7.6

There are no surprises on the list, which reflects reasonably closely the year-by-year estimates made during the 1980s by the Census Bureau. The Census Bureau was required to report the population figures by the end of 1990, but can make adjustments between now and July 15. Officials of larger eastern cities and some states (e.g., New York) are arguing that there is a systematic undercount disproportionately affecting minorities in central cities. If the current count stands, California will gain seven Congressional seats, Florida will gain four, and Texas will gain three, with no other state gaining more than one. The big loser would be New York, which would lose three seats, followed by several Midwestern states losing two seats each.

STATE FINANCIAL DETERIORATION

Introduction: New York officials set the tone for an austere year by their inaugural ceremonies. Four years ago, Governor Cuomo's ceremony drew some 5,000 people and featured symphony music and a 19-gun salute. This year, to save money and symbolize austerity, the governor and lieutenant governor were sworn in at a simple ceremony in the chambers of the state supreme court, with an audience of under 100. Not to be underspent, the attorney general and comptroller skipped any ceremony and will file written oaths of office. In his brief remarks, the governor said, "The months immediately ahead of us are going to be perhaps more difficult than any since the Great Depression."

Budget Shortfalls: Most governors, particularly the 19 new ones, hadn't decided on budget recommendations by early January, but their budget officers had developed appraisals of their current fiscal situations. According to a survey released by the National Association of State Budget Officers in January, the nationwide shortfall in the current year (FY 1991) is $9.6 billion or 3.2% of planned spending. Most states reported some shortfall. Table 5 includes all the states that did.

Table 5: Reported FY 1991 Shortfall As Percent of Spending
NOTE: States not shown did not report having a shortfall.

More Than 5%	3.1% To 5%	3% Or Less
California	Arizona	Alabama
Connecticut	Georgia	Colorado
Maine	North Carolina	Delaware
Maryland	Tennessee	Florida
Michigan		Indiana
Mississippi		Iowa
New Hampshire		Massachusetts
New Jersey		Minnesota
Pennsylvania		Missouri
Rhode Island		New York
Vermont		Ohio
Virginia		South Carolina

These reported shortfalls show considerable correlation with the latest state-by-state economic data reported below. There is also a strong correlation between the states with the shortfalls of over 5% and the TaxWatch list reported by State Budget and Tax News in October. There are quite a few cases in which shortfalls were minimized or denied by incumbent governors running for reelection. Particularly obvious are Maine and Pennsylvania where shortfalls of 5% of the budget would appear to have developed in the two months between early November and early January.

Employment Change: The latest data on employment changes by state appear in Table 6. Reversing a trend of the late 1980s, when growth of 2% or more was common, growth in the last year for which data are available was 1% -- about identical to the rate of population growth. Nine states show declines, with the six states in New England turning in the worst performance. Also notable is the relatively poor performance of the Southeastern states, except South Carolina where a hurricane affected last year's job levels and reconstruction has helped employment this year.

The data provide a reasonable proxy for the fiscal conditions being experienced by many of the states. Except Florida, the states in the top 20 are in reasonably good condition. While states like Indiana are reporting shortfalls and there are problems in balancing the continuation budget in Texas, the problems are not of the magnitude of those experienced by the states with little or no employment growth.

Table 6: Percentage Change In Employment, October 1989-1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	6.6%	18	Kansas	1.7%	34	Mississippi	0.7%
2	Utah	4.3	19	Minnesota	1.7	35	West Virginia	0.7
3	Washington	3.7	20	Kentucky	1.7	36	New Mexico	0.5
4	South Carolina	3.6	21	California	1.6	37	Missouri	0.4
5	Idaho	3.5	22	Iowa	1.5	38	Illinois	0.3
6	Florida	3.0	23	Wisconsin	1.5	39	Tennessee	0.2
7	Arizona	2.9	24	South Dakota	1.4	40	North Carolina	0.1
8	Nebraska	2.7	25	Louisiana	1.4	41	Pennsylvania	0.1
9	Oregon	2.6	26	Wyoming	1.4	42	New York	-0.2
10	Arkansas	2.4	27	Oklahoma	1.3	43	New Jersey	-0.3
11	Ohio	2.3		**United States**	**1.0**	44	Michigan	-0.3
12	Colorado	2.1	28	Virginia	1.0	45	Connecticut	-0.9
13	North Dakota	2.0	29	Alabama	0.9	46	Vermont	-1.7
14	Hawaii	1.9	30	Georgia	0.9	47	Rhode Island	-2.2
15	Alaska	1.9	31	Montana	0.8	48	New Hampshire	-2.8
16	Texas	1.8	32	Delaware	0.8	49	Maine	-3.1
17	Indiana	1.8	33	Maryland	0.7	50	Massachusetts	-3.1

Manufacturing Employment Changes: In recessions, manufacturing employment normally drops much more quickly and deeply than employment in fields like services and retailing. The extent of the drop has closely related to the severity of recession's impacts on individual states. The most vulnerable states have traditionally been the manufacturing oriented states of the Midwest, particularly those most dependent on motor vehicle manufacturing. Both car and truck purchases tend to decline in recessions. But some factors, probably the declining dollar and inventory policies of the auto manufacturers, have made this recession somewhat different. So while vehicle purchases by consumers are down sharply, manufacturing employment declines in the Midwest are less severe than in many other states.

Percentage changes in manufacturing employment are shown on Table 7, along with the total number of manufacturing jobs.

Table 7: Manufacturing Employment, October 1990 (000)
Plus Percentage Change In Manufacturing Employment, October 1989-90

Rank	State	Percent	Number	Rank	State	Percent	Number
1	North Dakota	7.6%	18	27	Alabama	-1.1%	380
2	Wyoming	5.5	9	28	Tennessee	-1.3	520
3	Utah	4.0	108	29	Hawaii	-1.4	20
4	Nevada	3.5	26	30	Washington	-1.4	366
5	Montana	3.1	23	31	Oregon	-1.6	218
6	Idaho	2.5	65		**United States**	**-1.6**	**19,129**
7	Nebraska	2.4	98	32	Pennsylvania	-1.7	1,026
8	Louisiana	1.7	177	33	California	-1.9	2,119
9	New Mexico	1.6	44	34	Missouri	-2.0	430
10	Arkansas	1.0	233	35	South Carolina	-2.1	382
11	Wisconsin	1.0	561	36	Florida	-2.3	529
12	South Dakota	0.9	32	37	Maryland	-2.5	203
13	Ohio	0.8	1,125	38	West Virginia	-2.5	85
14	Kansas	0.7	185	39	Michigan	-2.6	939
15	Delaware	0.6	71	40	North Carolina	-2.9	844
16	Colorado	0.3	195	41	Georgia	-2.9	554
17	Arizona	0.3	188	42	Connecticut	-3.2	346
18	Alaska	0.0	13	43	New Jersey	-3.4	630
19	Indiana	-0.1	635	44	Virginia	-3.4	415
20	Illinois	-0.2	979	45	Maine	-3.6	103
21	Kentucky	-0.3	285	46	New York	-3.8	1,146
22	Texas	-0.5	966	47	Rhode Island	-4.1	104
23	Mississippi	-0.5	243	48	New Hampshire	-4.8	106
24	Oklahoma	-0.6	162	49	Massachusetts	-6.1	522
25	Minnesota	-0.8	398	50	Vermont	-7.1	44
26	Iowa	-1.0	234				

The top gains are in the states with relatively small manufacturing sectors which don't have much impact on the overall condition of their state's economies. The other gainers, in the face of a 1.6% loss in manufacturing jobs nationwide, include Arkansas, Ohio, and Wisconsin. For recession conditions, it is unusual to find the job loss in states like Indiana and Illinois below the national average for job loss.

Federal Aid: In past recessions, there have been federal programs designed to put people back to work. Some of these, particularly a tax cut, are presumably clearly precluded by the federal fiscal situation. There are already signs of support for some expansion of federal spending. One would revive the past practice of extending unemployment compensation benefits. When workers exhaust their benefits (normally in 26 weeks), they would receive federally funded extended benefits running for up to an added 13 weeks. This action wouldn't affect state general fund budgets, but the funds would flow through state-administered UC funds. Another idea is to put additional money into infrastructure, such as permitting accelerated spending under existing programs, particularly the highway trust fuund. A more remote possibility is to put new federal money into public works construction. Such programs have, in the past, tended to have so much paperwork that their effects have been felt after the recovery from recession, not as recession-fighting measures.

Unemployment Trust Funds: As unemployment rates rise, disbursements from state unemployment compensation trust funds increase while income to the funds, from a payroll tax, tends to fall. If the result exhausts the fund, funds can be borrowed from the federal government with interest. States try to maintain reserves to avoid the need to borrow. But state officials and the labor and business leaders who influence the decision are also sensitive to the higher taxes needed to build up reserves. So state policies on reserves differ. So does the severity of the economic downturn each state faces and how well it was anticipated. It appears that Connecticut and Massachusetts will have to borrow in 1991 -- perhaps to be joined by some Midwestern states like Michigan, Minnesota, Missouri, and Ohio.

Under current ground rules, each state's payroll finances its UC payments, except when the federal government provides extended benefits to fight recession. From time to time, there is discussion of plans by which the states would, in effect, insure each other. For a discussion of these plans as well as state strategies on how much to put in UC reserves, see Wayne Vroman's Unemployment Insurance Trust Fund Adequacy In The 1990s (Upjohn Institute, 300 S. Westnedge Ave., Kalamazoo, MI 49007, 1990).

REGULATION OF FINANCIAL INSTITUTIONS

Introduction: Recent events support conclusions that state regulation of financial institutions is failing, but on examination the evidence isn't overwhelming.

Solvency Of Insurance Companies: Problems with state regulation of insurance companies are featured in "Regulator's Failure To Halt Insurer's Slide Shows Flaws In System" (Wall Street Journal, 12/31). The article is generally critical of state regulation, particularly Pennsylvania's. It illustrates the difficulties states have in dealing with companies headquartered in other states. The company, Lacop, ultimately proved unable to honor its claims. Letting its affairs get as bad as they did was conceded by Pennsylvania regulators as their failure.

Insurance buyers were protected in some states, which made independent decisions that the company couldn't sell policies there. Those states were Ohio, Illinois, Tennessee, and California. But many of the policies were sold in West Virginia which, unlike the others, decided to honor Pennsylvania's decision that the company could continue to operate. The article includes some indictments of state regulation and discusses pressure for federal action. But editorially, in the same issue, the paper asserts that federal performance in regulating S&Ls suggests federal takeover of insurance regulation wouldn't be helpful.

Forbes (1/7) ends its discussion of state insurance regulation with the comment:

> It's tough being a regulator in times like these. Err on the side of looseness, and you risk getting blamed for insolvencies. Err on the side of rigidity, and you risk restricting capital flows that create jobs and economic activity.

It its article, the magazine is critical of state regulators for tough guidelines on insurance company investments in junk bonds and other securities.

Financial Institutions Without Federal Insurance: Rhode Island's new governor made national news within two hours of being sworn in when he ordered the closing of 45 banks and credit unions. The news was less significant than it sounded because the bulk of Rhode Island banking is handled by 38 institutions in Rhode Island that have federal insurance and weren't affected by the closings. The institutions involved include two small conventional banks and eight "loan and investment banks." They are comparable to the industrial banks that created a crisis ultimately resulting in a bailout by Nebraska in the mid-1980s. Most states either never had such institutions or have forced them to assume characteristics of conventional banks and seek insurance from the Federal Deposit Insurance Corporation.

The remainder are credit unions. Large credit unions, accounting for about 97% of credit union deposits nationally, are regulated and insured by the National Credit Union Administration. Most states have forced credit unions, or all but tiny ones, into this federal program, but some state insurance remains comparable to the Rhode Island Share and Deposit Indemnity Fund. Besides Rhode Island, Massachusetts and Pennsylvania are apparently the only states with any form of state-insured banks and S&Ls.

The number of credit unions without federal insurance is shown on Table 8 (data from National Association of Share Insurance Corporations appearing in USA Today, 1/3, the listing differs substantially from one appearing on the same date in the Wall Street Journal that is attributed to a private financial publishing company). The table suggests that several states have a larger exposure than Rhode Island.

Table 8: Number and Deposits ($ million) of Credit Unions
That Lack Federal Insurance, 1990

State	Number	Deposits	State	Number	Deposits
Massachusetts	136	$2,888	Ohio	176	$835
Texas	287	2,530	Indiana	26	343
Illinois	73	2,145	Kansas	68	219
Florida	121	1,589	Nevada	7	165
Tennessee	190	1,539	Maryland	13	61
Washington	97	1,487	Idaho	28	53
Rhode Island	35	1,333	West Virginia	13	38
California	33	1,156	Iowa	2	7
Georgia	98	1,191	Oklahoma	1	7
Missouri	57	1,048	Wisconsin	1	5

After a problem with one of the state-insured institutions in November, Rhode Island was encouraging its insured institutions to seek federal insurance. But depositors weren't convinced, so they began a "run" on the state-insured institutions. The assets of these institutions, consisting largely of long-term loans, and the assets of the state's fund, may or may not be enough to cover all deposits in the long run. But in the short run, they couldn't cover the widespread demand by depositors to get their money immediately.

Will All States Drop Insurance Activities? It will take a while to sort out the Rhode Island situation. But it doesn't appear likely to be as serious as the failures of the state-insured S&Ls in Maryland and Ohio in the mid-1980s. At a minimum, depositors will have to suffer a period in which they cannot withdraw their money, and may not earn interest during that period. At worst, there will be pressure on the Rhode Island legislature to use taxpayer money to make good on the failures of the state insurance fund. The situation may cause other states to reassess the continuation of state-chartered financial institutions that aren't required to participate in federal insurance programs.

Federal Insurance And State Regulation: The interaction of the state authority to charter financial institutions with the federal programs of deposit insurance continues to cause friction. The 1989 federal legislation on S&Ls provided exceptions for savings banks, state-chartered institutions of which there were about 500 compared with 12,000 regular banks and S&Ls. Some S&Ls started seeking the broader authority of savings banks by attempting to convert to savings bank charters in the states that permit them. Legislation was also sought in other states to permit savings banks, an effort which the head of the federal Office of Thrift Supervision called "blatant attempts to evade the reforms enacted by Congress." Such laws passed in Illinois, Indiana, and Louisiana and probably some other states.

Banks In The Insurance Business: There has long been a dispute between banks and insurance companies over whether banks should be able to sell insurance. For banks chartered by states, this is a question of state law. This summer, Delaware enacted legislation allowing banks chartered by the state to sell insurance. Upon the signing of the legislation, major banking corporations, like Chase Manhattan and Citicorp, indicated they would be using the new power. Delaware's action makes it the second state to grant this broad power. South Dakota took a somewhat similar action some years ago, but its effect was tied up by Federal Reserve Board action, a contingency that could limit the effect of Delaware's action as well.

Bank Solvency: Essentially all major banks have federal insurance. So, unlike the situation with insurance companies and credit unions in some states, state finances are not at risk from any bank bailouts. However, the federal insurance fund is at risk. That fact and fear of a repetition of the S&L debacle have caused a significant tightening of federal bank regulation. It affects a variety of bank practices, particularly the classification of problem loans. That decision interacts with reserve requirements and the psychology of the industry to produce what many observers say is a significant tightening of bank lending. This can have major effects on state economies, at least this has been the view of some New England governors and Members of Congress who have expressed concern that regulatory pressures will cause further regional recession.

Because some of the alleged effects are psychological, it is difficult to quantify the situation in individual states. Table 9 attempts to provide an indication of relative severity by using research from USA Today (5/29) and Federal Deposit Insurance Corporation data to show capital as a percentage of assets.

Table 9: Bank Capital As Percentage Of Assets, 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Alaska	9.94%	18	South Dakota	7.47%	35	Idaho	6.55%
2	West Virginia	8.91	19	Missouri	7.39	36	Minnesota	6.55
3	Iowa	8.86	20	New Mexico	7.36	37	Connecticut	6.52
4	Wyoming	8.59	21	Utah	7.36	38	Illinois	6.48
5	Delaware	8.51	22	Vermont	7.33	39	New Hampshire	6.48
6	Arkansas	8.46	23	Tennessee	7.26	40	Michigan	6.43
7	North Dakota	8.29	24	Colorado	7.18	41	Massachusetts	6.32
8	Nebraska	8.19	25	Maryland	6.97		**United States**	**6.31**
9	Kansas	8.11	26	Rhode Island	6.91	42	Florida	6.31
10	Mississippi	7.98	27	Ohio	6.86	43	Hawaii	6.26
11	Alabama	7.95	28	South Carolina	6.84	44	North Carolina	6.21
12	Georgia	7.81	29	Washington	6.82	45	Nevada	6.16
13	Kentucky	7.78	30	Oregon	6.79	46	California	6.03
14	Wisconsin	7.75	31	New Jersey	6.63	47	Pennsylvania	5.97
15	Montana	7.70	32	Louisiana	6.57	48	Arizona	5.33
16	Oklahoma	7.63	33	Maine	6.57	49	New York	5.17
17	Indiana	7.49	34	Virginia	6.57	50	Texas	4.60

The table shows a reasonable correlation between bank problems and state economic problems as measured, for example, by employment change shown on Table 6. But the correlation isn't perfect. For example, Texas banks show low capital strength despite the Texas economic recovery, though banks in neighboring Oklahoma are in the top third of the states. Generally, the capital strength appears in states that haven't enjoyed rapid economic development over the past five years.

MISCELLANY

State Employee Compensation: As happens when **Reports** runs data on state salaries, as in Issue 20, there are complaints that the whole story isn't being told. This is more true in some cases than others.

For most employees, the stated salary is comparable to private salaries. As a result, it is not equal to annual average compensation for employees who receive overtime. Overtime is common with public safety personnel and, depending on staffing patterns, with institutional personnel such as corrections officers. It is also not true for persons receiving supplemental compensation for work during the year and/or summer work, as is true for a substantial number of teachers. No stated salaries, in public or private surveys, include non-cash compensation such as health care benefits.

A few state employees, such as some state park and mental health institution executives and maintenance personnel, receive housing for which they don't necessarily pay market values, which are hard to establish. So do governors, who typically receive lodging and some portion of their food. The arrangements vary from state to state and governor to governor so no one keeps track of them. Legislators receive so much special compensation in many states (e.g., special session pay, vouchered and unvouchered per diem pay, special pay for leadership and committee posts) that comparable numbers are difficult to obtain.

A few states allow private supplements of public pay in a few key positions, a practice prohibited by law at the federal level and in some states. For example, a private firm might supplement the pay of a state development director or a hospital might supplement the pay of a health director.

Undoing School Aid Formulas: New Jersey and Virginia illustrate contrasting aspects of changing school aid formulas that have already been enacted.

Virginia's problem arises because it has already enacted its FY 1992 budget as part of the biennial budget decisions made early in 1990. Since then the fiscal situation has deteriorated significantly. The governor's austerity measures dealt with the FY 1991 shortfall by devices not likely to cause public outcry, such as eliminating lottery funding for capital projects and using the money to avoid cutbacks in state operations. For FY 1992, more substantial actions are necessary. Part of the governor's response is to propose substantially higher percentage cuts in state aid in the affluent counties (e.g., those around Washington, DC) than in the less-affluent, predominantly rural, counties.

New Jersey's problem comes because the equalization aspects of the 1990 legislation haven't been popular. An inherent result of equalization is that the affluent districts must pay more from local taxes if they wish to maintain their above-average per-pupil spending. One mechanism causing this result is requiring about 150 affluent districts to absorb, over a five year transition, roughly $400 million in pension costs previously funded by the state. Skipping the first year of absorption has been suggested as a way to attenuate some of the adverse reaction to the total package -- which tends to hit affluent taxpayers through income taxes, sales taxes, and, depending on where they live, property taxes.

Community Development: The National Conference of State Legislatures recently released NCSL Community Development Survey, a survey of state community development policies. The 12-page survey report contains no analysis of advantages and disadvantages of particular policies, nor any state-by-state listings. Instead there are tabulations of the number of states with programs of various kinds, ranging from economic development, to housing, to job training. The authors find some legislatures are attempting to put these together as a community development strategy, but "the majority of legislatures are still viewing the elements of community development as separate and unrelated to a comprehensive strategy."

Homeownership: The percentage of households that own their homes was 64% nationwide, according to recent Census Bureau statistics. This represents a slight drop from the 66% rate in 1980. The state rates are shown in Table 10.

Table 10: Homeownership Rate, 1989

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	West Virginia	74.8%	18	Minnesota	68.3%	35	Georgia	64.7%
2	Maine	73.6	19	Indiana	68.2	36	Florida	64.4
3	Michigan	73.2	20	Kansas	68.1	37	Washington	64.2
4	Pennsylvania	72.8	21	Montana	67.9		**United States**	**63.9**
5	Mississippi	72.2	22	Alabama	67.6	38	Arizona	63.9
6	Oklahoma	71.4	23	Tennessee	67.3	39	Missouri	63.7
7	South Carolina	71.0	24	Nebraska	67.2	40	Oregon	63.4
8	Utah	70.4	25	North Dakota	67.1	41	Illinois	61.9
9	Idaho	70.2	26	New Hampshire	67.0	42	Rhode Island	61.2
10	Virginia	70.2	27	Connecticut	66.4	43	Texas	61.0
11	Vermont	69.7	28	Arkansas	66.3	44	Massachusetts	58.9
12	Iowa	69.6	29	Louisiana	66.3	45	Alaska	58.7
13	Ohio	69.6	30	South Dakota	65.8	46	Colorado	58.6
14	Wyoming	69.6	31	New Jersey	65.7	47	Hawaii	54.7
15	North Carolina	69.4	32	Maryland	65.5	48	Nevada	54.3
16	Wisconsin	69.3	33	New Mexico	65.5	49	California	53.6
17	Delaware	68.7	34	Kentucky	64.9	50	New York	52.3

Homeownership has been an objective of national housing policy for decades. It generally correlates with a propensity to vote and is inversely related to crime rates. But these relationships with homeownership aren't necessarily proof that homeowership itself would cure significant social problems. Homeownership tends to correlate with age, as does voting and refraining from committing crime. The age relationship explains some, but not all, of the state rankings. Among householders over age 50, 77% owned their homes while the rate was 39% for those under age 35.

TECHNICAL NOTES

Economic Development: The Review is published by the Corporation for Economic Development (777 North Capitol St., NE, Washington, DC 20002). Besides the article cited, other approaches to "third wave" development are presented in the issue, including articles by Walter Plosila (Montgomery (MD) High Technology Council) and Richard Hatch (Manufacturing Network Project). In June, Governing published an article, "A Third Wave of Economic Development," by John Herbers which featured programs in Pennsylvania, North Carolina, and Michigan and Ross's comments on the principles of the third wave. Ross's perspectives are also featured in Points West (Spring 1990, Center for the New West, 600 World Trade Center, 1625 Broadway, Denver, CO 80202). Ross and David Osborne contributed "Catching The Third Wave" (Washington Post, 7/22/90).

Enterprise Zones: A recent review of enterprise zone proposals from a federal perspective is Federal Enterprise Zones: A Poverty Program For The 1990s? (Bret Birdsong, Urban Institute). Birdsong suggests that a program of investments in human resources in target areas would be preferable to the zone proposal being considered at the federal level. He concludes, "Careful evaluations of state enterprise zone programs have found no evidence that incentives have contributed to employment or investment growth in designated areas. In the zones where growth has occurred, it cannot be attributed directly to enterprise zone incentives."

The annual evaluations of the Indiana program are likely to be especially of interest to **Reports** readers because they are done by James Papke, who has been used as a consultant on tax policy by about half the states. The latest is The role of Market Based Public Policy In Economic Development And Urban Revitalization: A Retrospective Analysis And Appraisal Of The Indiana Enterprise Zone Program (Krannert School of Management, Purdue University, West Lafayette, IN 47907). The 135-page report finds no provable relationship between the tax incentives and job creation, that few jobs go to the intended target population, and that the cost per job is high. It suggests the current Indiana enterprise zone tax preferences are "expensive, regressive, and ineffective."

High Tech Incentives: The survey was printed in Site Selection (7/1990).

Evaluation: The quotation is from Harry Hatry. Mark Fall, Thomas Singer, and Blaine Liner, A Manual: Monitoring The Outcomes Of Economic Development Programs (Urban Institute, 1990). The manual is several hundred pages of information on evaluating development programs produced by the Institute in cooperation with the states of Maryland and Minnesota. For an example of the types of detailed assessments that some states have undertaken, see Mt. Auburn Associates (408 Highland Ave., Somerville, MA 02144), The Economic Impact Of Business Financing By New York State Agencies.

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VOLUME 9 ISSUE 3

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Strategies to cut spending often emphasize across-the-board measures such as uniform percentage budget reductions, hiring freezes, and employee furloughs. Some of these are unlikely to produce the announced savings. There are many possibilities for more permanent cuts, but tough decisions are involved as Massachusetts illustrates.

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The war in the Middle East should have little immediate impact on state economies and budgets.

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Miscellany deals with state progress in dealing with drug abuse, financial institutions regulation, pay raises, statistics on personal income and voter turnout, R&D spending, school governance, and more. Technical notes indicate data sources.

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February 1991 (First of Two February Issues)

THE STATE OF THE STATES

Introduction: The governors didn't have a common theme in their inauguration and state-of-the-state messages this year. Most of them avoided talk of taxes and details of budget cutting -- choosing only to emphasize austerity, doing more with less, and living within available resources. This cut off discussion of expensive initiatives such as state versions of universal health care, substantial improvements in education through costly measures like smaller class sizes, or major expansion of state programs for children. The state-of-the-state message, particularly in states with separate budget messages, is the vehicle for stating legislative initiatives and exercising leadership, so it wasn't generally the vehicle for describing cuts.

The State Of The State: Governors, particularly in the East, had discouraging words about the state of their states. Governor McKernan (R-ME) commented, "There have been few times in the history of this state when the dual threats of war and a faltering economy have so dramatically and precipitously affected our lives."

A common pattern was to couple mention of past and current problems with an upbeat theme for the future. After indicating the months ahead might be more difficult than any since the Depression, Governor Cuomo (D-NY) covered the theme in one sentence: "But this state has overcome fires and floods and Depression and wars, always bringing us to a higher ground." Governor Wilson (R-CA) opened his administration this way:

> Neither drought nor freeze will stop us. We will recover. Not war, not recession. We will triumph in the end. Not a 40% high school dropout rate. We will keep our kids in school and teach them to compete and win. It will take time and discipline, but our course is clear. We will not suffer the future, we will shape it.

Governor Florio (D-NJ) defended last year's tax increases -- "We made choices others are just starting to face up to." He asserted, "In 1991, we're the strongest state in the region." Governor Thompson (R-WI) talked of a Wisconsin that outshines other states.

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The Language of Austerity: The governors asked legislators and the public to buckle down to the business of sacrifice. Governor Weicker (I-CT) said, "What I seek is your grit and ingenuity -- your resolve to accept sacrifices long postponed to gain achievements long denied." Governor Cuomo talked of a "new austerity" that must be evenly spread. He advocated "new thinking instead of new spending." On how cuts will be allocated, he said, "there will be no sacred cows, and there will be no sacrificial lambs."

Governor Wilder (D-VA) said simply, "Clearly, now is not the time to initiate new programs or to expand discretionary spending on existing programs." Governor Weld (R-MA) emphasized not just balancing the budget for a single fiscal year but a multi-year perspective involving budget cutting "bound to offend some and anger others." Governor Carlson (R-MN) said, "We can no longer look to government to do all." Governor Chiles (I-FL) commented simply, "We're out of money." Governor Miller (D-GA) told the combined appropriations committees of the Georgia legislature, "It's belt-tightening time."

In a message not everyone would necessarily agree with, Governor Sundlun (R-RI) said, "I do not fear unpopularity because better fiscal management is more important than political popularity."

Economic Development: Governor Weicker discussed stimulating the economy to "rekindle business" and "save and expand jobs." Governor Florio offered a program, "New Jersey Works," designed to create additional construction jobs by public works and loans to first time homebuyers. The construction money is money from existing sources -- state and federal transportation funds plus spending of the Port Authority of New York and New Jersey. Governor Gregg (R-NH) talked about capital shortages from banking problems, announced an attempt to expand public works spending, and offered the creation of a new public-private venture capital fund.

Rejecting some prior development programs in his state, Governor Engler (R-MI) said, "No bureaucratic decision as to who should be an economic winner or loser will ever substitute for the decisions made in the marketplace." Endorsing continued public works spending, Governor Schaefer (D-MD) asked, "If the state won't invest in Maryland, how can we expect businesses to?"

Program Recommendations: There were few recommendations of new programs. Major new education reform proposals weren't on governors' agendas, except in Tennessee. Discussion of expanded health care for the indigent consisted primarily of announcing expansions of coverage mandated by federal law. Universal health care proposals produced by blue ribbon committees in many states remain on the shelf, generally unmentioned in the messages. Governor Cuomo discussed universal health care, but said New York couldn't afford to act on the subject.

Instead of costly new programs, the governors and their speechwriters concentrated on previously planned expansions of state activity, such as the continuing implementation of education quality programs adopted on a multi-year basis in the past. They also discussed federally financed activities, like the use of new federal Headstart funds and low-budget state initiatives.

Entrepreneurial Government: Governor Weld talked about "fewer rules and more results" which he called his definition of "entrepreneurial government." This was to replace "bureaucracies 50 years out of date, sluggish and centralized, in which hierarchies rule and orders are issued from the top in a power pyramid." He said such a system might have worked for an economy of shoe manufacturers but that it could impede growth in "the information-rich, knowledge-intensive society of the 1990s."

Prevention: For California policy, Governor Wilson used a theme of substituting prevention for remediation -- "a vision of government that is truly as uncomplicated as the old adage that an ounce of prevention is worth a pound of cure." He mentioned examples -- prenatal care rather than neonatal care, drug education rather than drug treatment, preventing learning disorders rather than compensatory education, preventing dropouts rather than counseling teen mothers, and preventing crime rather than punishing it.

Tax Policy: The governors generally saved any tax-increasing ideas for their budget messages. But those who support cutting taxes were eager to talk about it. Governor Engler (R-Mich) said the people demand a tax cut and promised, "We will cut taxes." Those not proposing tax increases yet used language similar to Governor Weicker (who may be proposing an income tax for Connecticut): "I have a feeling the people of this state would rather take their licks and be done with it than be nibbled to death by political solicitousness." Some governors rejected tax increases, as Governor Chiles did. He argued that tax reform might be appropriate later, but that first Florida officials should gain voter confidence in state government by such actions as ethics reform. He hinted that his idea of reform involved a broader base for the sales tax.

Federal Policy: Governor Cuomo repeated his constant theme that the federal government has withdrawn from its major social obligations for dealing with drugs, homelessness, crime, and AIDS. He concluded, "The cumulative weight of this decade-long shift of the burden, combined with shrinking revenues as a result of the national recession, is crushing many states, including New York." Governor Wilder promised, "The irresponsible fiscal fantasies of Washington will not take root in Virginia." He said national economic recovery would come faster if Washington "would get its fiscal house in order." Governor Chiles commented, "When I left Washington, the federal government was beached on a bloated and inefficient bureaucracy, totally unresponsive to the needs of the people." Governor Miller said in the 1980s the federal government shifted costs to states that prosperity made it possible for them to absorb. But now, he said the days of eating "rainbow stew" were over. Governor Ashcroft (R-MO) said 85% of Missouri's new revenues were needed just to cover costs associated with mandates from courts and Congress -- a situation he described as a "modern mutation of federalism."

Personal Responsibility: Without talking about the 1,000 points of light used by the President in a similar context, some governors did stress individual effort. For example, Governor Engler called upon Michigan citizens to accept personal responsibility for improving their communities, just as they had done in the early settlement of the state. Governor Chiles commented, "Programs don't work, people work." He suggested that "people are better than the system that is governing them." Suggesting that neither Washington nor Tallahassee offered solutions to all problems, he said he was volunteering to be a mentor to an at-risk student and to teach this summer.

BUDGET BALANCING STRATEGIES

Introduction: In his state-of-the-state message, Iowa's Governor Branstad delivered a succinct summary of the view of many state elected officials: "In a nutshell, we're spending too much money."

In most states, there is an imbalance in current budgets and projected budgets for FY 1992. Many governors and legislators don't want to raise taxes. As the National Governors' Association executive director told the press after describing state shortfalls, "I think you're going to see taxes substantially off the table next year." The governors' state-of-the-state and budget messages suggest most of them want to avoid tax increases. But this preference doesn't mean they will be avoided. Whether tax increases will appear as a viable policy late in the legislative sessions depends in part on how well the tax-avoiding budget-cutting strategies work.

Michigan's Dilemma As An Example: The debates now taking place in the Michigan legislature are indicative of the choices yet to be made in many of the states. Michigan's past policy choices and current economic conditions are carrying the state toward a major tax increase. Michigan's politics are steering the state far away from one. The two sets of preferences had to collide. They have.

Michigan has opted for relatively expensive state policies in relation to its economic capacity. Its spending per pupil is above average, its standards for participation in welfare programs relatively generous, and its costs of Medicaid and AFDC well above average. The state has been maintaining these policies during years when its major industry, vehicle manufacturing, has been losing market share both to foreign suppliers and other parts of the country. Its economic situation was relatively poor even before the onset of recession. The state maintained its spending in part by shrinking the percentage of public school costs it paid, creating widespread opposition to property tax burdens.

In the pre-election FY 1991 budget, both the incumbent governor seeking reelection and the Senate president working to get the job adamantly maintained a no-new-tax posture. The result was a budget that probably wasn't balanced when enacted, as indicated by a budgeted reduction in spending for Medicaid while similarly situated states were anticipating double-digit increases.

Immediately after the election, the legislature recognized the problems. One step was to make appropriations more realistic by adding $340 million in supplemental appropriations and restoring some spending previously vetoed by the governor. This, of course, threw the budget further out of balance. Then the legislature adopted a plan of cuts. It protected public school aid, higher education (with only a 1% cut), and other items like debt service. Everything else was cut over 9%, which would swell to 12% by the time the new governor was inaugurated and had a chance to make implementing recommendations. If implemented and combined with certain accounting changes, like converting certain tax refunds to grants and presumably paying them later, the changes would bring FY 1991 into at least theoretical balance.

In January, the legislature began to face the realities of implementing the cuts. One major issue being debated is assistance programs for the poor. One choice, being urged by the Engler Administration, is elimination of the general assistance program. It provides cash assistance to 125,000 persons who aren't eligible for programs with federal cost sharing, for example, for adults under 65 without minor children. The other alternative is to cut general assistance less or not at all and reduce the state spending for AFDC and Medicaid, which also reduces the federal match. Some argued that the sudden withdrawal of state funds would force the state out of the Medicaid program entirely because it would be violating federal requirements.

Some legislators are looking for ways to save the social service spending, starting with using up the state's rainy day fund. Then there would be direct and indirect tax increases, such as cutting an existing property tax relief program and broadening the base of the sales tax to services. Meanwhile, the governor is seeking ways to implement his campaign pledge to cut property taxes. Doing so while maintaining spending would presumably require new local non-property taxes or the increase in the state sales tax presented to voters (and rejected by them) several years ago. But cutting property taxes could also mean preventing future increases of the magnitude that would otherwise occur, so the governor has proposed limits to property tax increases as well as a complex revision in assessment rules.

Pennsylvania Budget-Balancing Measures: After successfully campaigning on the basis of having avoided tax increases, Pennsylvania's Governor Casey announced in December that massive cuts would be required to balance the current year budget. He announced budget gap-closing measures totalling $731 million. Just under 40% of those were reductions in spending such as cutting the state's workforce by 2,000 persons and cutting the higher education allocation by 3.5%. The other items included: (1) spending money from other accounts (the rainy day fund and a surplus from past appropriations for legislative operations), (2) improving tax collections, (3) deferring spending by delaying when employees are paid, and (4) a plan that, in effect, obtains contributions from hospitals to provide the state's match of federal Medicaid funds.

Budget-Balancing Measures Nationwide: If budgets are out of balance, if balance is required by state constitutions and statutes, and if tax increases are ruled out, it would seem to follow that spending must be cut. But significant spending cuts are difficult. So there is an understandably diligent search for ways to balance budgets without raising taxes or cutting spending. The result shows in a recent survey of state actions to close budget gaps shown as Table 1.

Table 1: State Strategies To Close FY 1991 Budget Gaps

Gap-Closing Strategy	Number Of States
Hiring And Travel Freezes	26
Selective Reductions Of Particular Programs	22
Across-The-Board Cuts	16
Deferred Spending	15
Layoffs	14
Rainy Day Funds	12
Internal Borrowing Or Fund Shifts	12
Furloughs	9
Reduced Or Delayed Pension Contributions	6
Revenue Or Tax Increases	4
External Borrowing Or Bonding	4

Revenue Increases: Many of the listed strategies don't cut spending at all. They simply tap new sources of revenue to finance the spending. "Revenue Or Tax Increases" clearly do this, whether the result is called a fee increase or a tax increase. Other mechanisms simply draw money from another source to finance spending. With "Rainy Day Funds" and "Internal Borrowing or Fund Shifts," the money comes from another state source. With "External Borrowing Or Bonding," it comes from the securities market.

Because attention is generally focused on state general funds, it is easy for the media and public to confuse these budget balancing measures with spending reductions. For example, considerable attention has gone to the large budget deficit in Virginia and the governor's resolve to handle it without new taxes. Part of the method involves funding shifts. For example, lottery proceeds are being shifted from special purposes like university construction to supporting the budget. The construction may be financed by bonding and/or the use of yet another state fund. Some states have considerable capital outlay that can be shifted to bonding, an approach that has helped Mississippi and Texas expand spending over the last several years.

Two major targets of state budget cuts -- aid to local government and support of higher education -- have an element of substituting revenues for cuts. However, how much of a cut will be offset by higher revenue from tuition and fees or local taxes often isn't known when the state cuts are made.

A special case of increasing revenues comes from the sale of government assets. In some cases, the government simply leases back the asset. This form of lease-purchase differs little from outright borrowing in economic impacts. West Virginia has sold its state liquor monopoly as franchises to operate individual liquor stores, with about a $20 million one-time gain in FY 1991 from the sale. Virginia's governor wants to sell the state's historical ownership in a private railroad. New Jersey's governor is proposing selling some state roads to the turnpike authority.

Spending Deferrals: The categories in Table 1 of "Deferred Spending" and "Reduced Or Delayed Pension Contributions" only reflect movement of spending from one fiscal year to another. With pension obligations to employees unchanged, deferring the state contribution to the pension fund merely delays the outlay. A common non-personnel expense to be deferred is paying Medicaid bills. This was one of the ways Massachusetts finances got out of hand, but isn't uncommon elsewhere. For example, the current Illinois budget was balanced using delayed payments of medical bills. Other items frequently delayed are payments to local government and tax refund payments. The new budget for Rhode Island, for example, "saves" a month of school aid payments by shifting them to a later date.

A special case of deferral is paying employees by slipping the payroll date -- for example, paying employees two weeks after their work rather than one week. The "lag payroll" New York adopted in December is the ultimate deferral. Employees don't get one week's pay until they retire, die, or quit.

Appointing A Committee: Many of the new governors have appointed outside groups to examine state spending and programs. New Jersey's governor did this last year. Georgia's governor is doing it this year. So is Florida's with a new group that will, in the words of the governor:

> ... explore and provide the road map for right-sizing our government, to provide more competition in our governmental processes, to show us how to measure outcomes, to give money on the basis of measured results rather than on inputs, so that we can properly evaluate whether state government is providing services that result in customer satisfaction. And the customer for us has got to be you, the taxpayer.

Reforming The Budget Process: The states have not matched the federal propensity to accompany nearly every unbalanced budget with a package of procedural reforms designed to avoid an unbalanced budget the following year. But budget reform proposals are common. In New York, the governor and some legislative leaders believe reform is moving the start of the fiscal year from April 1 to July 1. In Georgia, the chairman of the House Appropriations Committee has a reform bill to move the start of the fiscal year from July 1 to April 1. Constantly, there are proposals to reform how executive budgets are formulated (e.g., zero-base budgeting). There are also proposals to reform the format and detail of appropriations bills and the process and timing of their legislative consideration. For example, in Massachusetts, the new governor wants to end the heavy orientation of the state's budget to detailed line items.

CUTTING STATE SPENDING

Looking For Real Spending Cuts: Deferring spending and getting extra money to finance, rather than cutting, spending, account for six of the 11 budget balancing measures listed on Table 1. In the remaining five measures, state officials are working off a tried and true list of budget-balancing devices. In the process, they are counting on many cost savings that past state experience suggests often won't materialize. If that assertion is true, there will be more, and larger, state tax increases this year than are currently being discussed.

Cuts With Unspecified Programmatic Impact: A common view of citizens and many elected officials is that state budgets have waste, reflect mismanagement, contain fat, and include low priority programs. The difficulty comes in determining which appropriations are the culprits. Many positions on state budgets finesse this question. Examples: (1) ceilings on state taxes or a general position that they shouldn't be increased and (2) constitutional or statutory limits on state spending. These devices are of no use to a governor seeking to balance a budget in mid-year by administrative action. But there are parallel devices which can be used to reflect an intent to cut without making decisions among programs. The across-the-board cut is the clearest example.

Across-The-Board Cuts: Across-the-board cuts are conceptually designed so that the governor doesn't set priorities among programs -- instead applying the same percentage reduction to each. The only inherent exception that is generally recognized is debt service payments under existing bond contracts. However, in many states, there have been up-front exceptions for school aid, for agencies (e.g., corrections) under court order, and because of policy decisions to apply a lower percentage to some activities than others. The Michigan cut described above is an example of an across-the-board cut with many exceptions. The exceptions don't obviate the efficiency of the across-the-board cuts where they apply, but do reduce the persuasiveness of the cuts to those being asked to implement them and, of course, reduce the dollar savings that can be produced by any percentage reduction.

The main problem with the across-the-board cut is that it isn't necessarily implemented. Massachusetts was constantly announcing such cuts in 1989 and 1990 without reducing the budget. As is usually the case, the cuts were actually directions from the governor to agency heads to make proposals to achieve the necessary reductions. Often agencies not subject to the administrative control of the governor, such as those headed by independent elected officials like attorneys general and secretaries of state plus the courts, simply don't comply. Agency heads appointed by the governor don't always comply or comply with cuts the governor finds unacceptable, as happened with social service programs in Massachusetts. The process of negotiations takes enough time so that the cuts, even if made, don't have the fiscal impact originally anticipated.

Personnel Reductions: Three of the cut mechanisms shown on Table 1 focus on reducing the costs of state personnel. These are predicated on the assumption that the best area for cost cutting is direct state operations. Excluded are state-paid or partly state-paid personnel working for universities, public school systems, private clinics, and other contractors of the state. One approach is simply to reduce the number of state personnel quickly by layoffs. A second approach avoids layoff but reduces the work time and pay of all employees by mandatory furloughs. A third approach reduces the state workforce by not hiring workers to replace those that leave, the hiring freeze.

The difficulty with all three policies is that they tend to be eroded by exceptions -- each apparently meritorious, but together eroding the cost savings of the policy. The problems become clear when exactly who works for state government is considered. Table 2 shows the employment in October of 1990 of Illinois -- a typical state in spending patterns though larger (11.5 million people) than most.

Table 2: Illinois State Government Employment, October 1990

CATEGORY/Agency	Number of Employees		Percent of Total
INDEPENDENT CONSTITUTIONAL OFFICES		10,011	12.9%
Sec. of State (inc. vehicle licensing)	4,581		
Courts	2,145		
Comptroller	452		
Treasurer	147		
Attorney General	732		
Board Of Education	943		
Other State Officers	1,011		
AGENCIES OUTSIDE THE GENERAL FUND		13,156	17.0
Employment Security	2,912		
Transportation	8,369		
Toll Highway Authority	1,875		
AGENCIES MANAGING INSTITUTIONS		28,566	36.8
Mental Health	13,761		
Corrections	11,600		
Children & Family Services	3,205		
REVENUE-RAISING AGENCIES		3,406	4.4
Lottery	328		
Revenue (tax collections)	3,078		
OTHER AGENCIES		22,437	28.9
Agriculture (inc. regulation)	723		
Commerce and Community Affairs	711		
Central Management (inc. Personnel)	1,328		
Conservation (parks)	1,566		
Veterans Affairs	878		
State Police	3,642		
Public Aid (welfare)	9,934		
Public Health	1,321		
Rehabilitation Services	2,054		
Others Not Listed Separately	4,929		
TOTAL		77,576	100

Exceptions To Personnel Reductions: The erosion of the concepts of furloughs, layoffs, and hiring freezes is easily understood with reference to Illinois staffing as shown in Table 2. The major cases fall in these overlapping categories.

Revenue Generators: If budget-balancing is the objective, then it is counterproductive to eliminate personnel who bring in revenue. This argues for exempting 4.4% of Illinois employment in the lottery and tax-collecting agencies, plus personnel in other agencies who collect driver's license fees, vehicle registration, liquor taxes, insurance taxes, and generate fees from regulation that exceed their costs. This argument can be extended to the investment activities of state treasurers, collection activities of attorneys general, much of the court system, and more.

Special Funds: Some 17% of Illinois employees are in agencies where savings from laying them off, furloughs, or hiring freezes would reduce spending in some special fund without directly helping the general fund. The toll highway authority lives from tolls, the transportation agency lives primarily from earmarked federal highway aid and state gasoline taxes, and the employment security administration lives on federal aid and earmarked Unemployment Compensation taxes. Also in this category are those paid by smaller earmarked funds such as 100% federally funded positions and fish and game agencies.

Independent Offices: In Illinois, 13% of employment is under the control of constitutional officials, other than the governor and lieutenant governor. These officers do not need to respond to administrative decisions by governors and often participate in austerity measures only in a token fashion.

Institutions: While not all the employees of the three Illinois institutional agencies shown in Table 2 are working in institutions, many are. Employment in those agencies consists primarily of the lower paid employees (e.g., food service workers and prison guards) whose positions are most affected by hiring freezes because of high turnover. In many of these positions, activities are controlled by rigid staffing ratios effective 24 hours a day -- two guards per prison wing plus one supervisor for three wings or one mental health attendant per 30 patients. Unless they can cause changes in these ratios, governors and budget officers will generally approve exceptions to hiring freezes to maintain the ratios. Policies that reduce employment but don't reduce the ratios increase cost because they require that posts be manned by personnel working overtime.

Other Situations: There are other reasons why many exceptions are granted to hiring freezes and general layoff guidelines. Examples: (1) staffing required by court orders and accrediting standards, (2) replacements in one worker-one job situations like the independent board with one secretary or the park with a single naturalist, (3) political considerations, such as keeping the decentralized Illinois veterans offices open, and (4) priorities, such as not laying off the state police personnel associated with drug enforcement.

CUTTING THE MASSACHUSETTS BUDGET

Introduction: The lack of consensus on the appropriate size of a state budget is about as high in Massachusetts as in any state. During 1989 and 1990, the legislature was adopting tax increases at the same time that a major taxpayer group was trying to roll back previous tax levels. In the 1990 election, the voters made three decisions that weren't entirely consistent. They: (1) adopted a measure requiring the state to devote a fixed percentage of revenue and revenue growth to local government aid, (2) rejected the proposition to roll back taxes, and (3) elected the gubernatorial candidate who supported the rollback. Trying to assess whether the state spends too much has preoccupied various task forces and recently gave rise to a detailed report by the Federal Reserve Bank of Boston.

The Search For Cuts: The report concludes that the average citizen sees little of state government spending because it goes to local aid (where its effects are perceived as local spending) and to the minority of citizens affected by income-tested programs like Medicaid. As a result, it suggests the dialogue about state spending is preoccupied with "waste." While conceding there may be some (e.g., in excessive numbers of universities), it argues that the big money is elsewhere, so:

> The conclusion that emerges from this survey of state government expenditures is that, for the most part, the Commonwealth has been spending revenues on activities that many, if not most, voters would consider worthwhile. The difficulty is that, while strong revenue growth during the prosperous 1980s permitted the state to spend liberally while taxing conservatively, the economy has slowed and these divergent policies toward spending and taxes can no longer persist.

The report doesn't encourage major spending cuts. It argues that while the state could save two-thirds of its Medicaid budget by eliminating optional benefits, the cuts would be "drastic" and some costs would rebound in other public programs without the federal Medicaid cost sharing. Welfare benefits are higher than in most states but provide "only a modest standard of living." The report mentions possible savings in child support enforcement, but the state's record is better than most states. It advocates savings through preparing welfare parents for jobs, but suggests the current (ET) program does not appear to have reduced welfare caseloads. On state-delivered social services, the recommendations aren't very specific: "redundancies must be eliminated, coordination improved, controls tightened, and priorities established."

Nor are many savings offered in state employee costs, other than higher deductibles and co-payments and possible use of preferred provider organizations for health insurance. Cash compensation is found reasonable in relation to other states, as is the level of staffing. Debt service, though growing, is also found to be reasonable, with indexed bonds offered as a way to deal with the cost escalation.

Local aid is offered as a potential area for reconsideration, with more possible emphasis on equalization among jurisdictions with differing wealth and less on reducing pressures on the property tax. Local option sales and income taxes are rejected for two reasons: (1) the aggravation of existing fiscal disparities among large numbers of small jurisdictions and (2) the ease of crossing borders to a jurisdiction without a tax.

Deferring capital investment is rejected as a strategy. But the Bank's staff urges priority setting, putting into competition not only the state's own capital spending plans but also those of the many independent state authorities. It cites with approval the authority of New Jersey's governor to veto authority capital spending. Kentucky has adopted a comparable capital planning procedure for dealing with authorities.

Medicaid: Using unpublished federal data, the Bank's staff calculated Medicaid recipients as a percentage of the state's entire poverty population for selected states. The results appear in Table 3.

Table 3: Medicaid Recipients As Percent Of Poverty Population, FY 1989

State	Percent	State	Percent	State	Percent
Massachusetts	111.9%	New York	82.6%	California	67.8%
Connecticut	97.8	Maryland	80.5	Illinois	59.6
Vermont	92.3	Washington	76.7	New Hampshire	58.1
Rhode Island	92.2	Pennsylvania	73.7	North Carolina	53.0
Maine	90.5	New Jersey	72.5	Texas	43.0
Michigan	83.7	**United States**	67.8		

But the report finds fault with various potential limitations on the population served by the state's Medicaid system. So it turns to other ways to reduce costs, and finds problems with most of them. Instead, it concludes:

> Because Medicaid operates as part of the state's high-cost health care system, it cannot be reformed in isolation. Achieving ongoing savings within Medicaid requires curing cost increases throughout the entire health care system.

Massachusetts Revenues: The chapter on revenues expresses considerable concern with volatility of revenues, though it finds the state's revenues no more prone to fluctuation than the states used for comparison. The flat rate income tax leads to stability, compared with a graduated one. But the high reliance on a corporate income tax and a sales tax with necessities exemptions (e.g., food, medicine, and utilities) make for greater volatility. All things considered, state revenue will grow about as fast as personal income in the 1990s, but local revenue will grow more slowly. Higher user fees and an extension of sales tax to necessities would reduce volatility, but also reduce the progressivity of the state's tax structure.

The report's assessment of spending pressures and of state and local revenues from existing taxes suggests the possibility of a structural deficit. With the possible revision of state aid to local government, the problem would be concentrated in local government. The suggested relief takes the form of relaxing the Proposition 2 1/2 property tax limits.

Mental Retardation Programs: A separate study on Massachusetts spending is by Edward Moscovitch, a former Massachusetts budget officer. He assesses the state's programs in comparison primarily with Michigan and Minnesota. The 100-page study concludes the state is out of step with other states primarily because it has done less to take people out of state residential institutions and put them in the community. To make the problem more expensive, Massachusetts spends much more than other states on those people who are in institutions. Part of the problem, Moscovitch says, was a bad decision to enter into a judicial consent decree that governs conduct of the residential program. He proposes more use of community care, with savings shared by the taxpayer and community programs. But he comments that "the savings cannot be accomplished overnight and cannot be achieved without overcoming serious political and legal obstacles." In his words, his plan "takes as its starting point the needs of the people served and not the priorities of legislators, public employees, or program advocates."

Moscovitch had to do some calculations to translate generally available data on mental retardation budgets into per capita and per resident terms, but the result shows the potential of such interstate contrasts. Table 4 reflects key elements of one of his tables comparing Massachusetts with Michigan, Minnesota, Wisconsin, New Jersey, and Connecticut.

Table 4: Selective Comparisons Of Retardation Programs, FY 1988

Comparative Measure	MA	MI	MN	WI	NJ	CT
Total Cost Per Capita ($)	104	51	77	48	62	119
Percent Federal (%)	28	34	48	34	31	19
MR Residents in State Inst. (%)	40	19	17	20	56	44
Cost/Resident, State Inst. ($000)	100	81	60	52	48	68

Avoiding a consent decree like the one in Massachusetts and the one affecting its correctional system has been a major consideration for New Mexico. Its litigation on the subject began in 1987 and recently resulted in a federal district court decision that may be appealed. Even if it accepts the decision, it will have considerable flexibility to close its residential retardation facilities, although there is legislative opposition to doing so.

Institutional Scale-Backs And Closings: In both mental health and mental retardation (developmental disability), there has been a shift in professional opinion away from keeping people in institutions for long periods. For therapeutic and humane reasons, there is interest by professionals and some advocacy groups in community programs. But some states have been slower than others to reduce their institutional populations, even though substantial savings can result from doing so even after using some additional money for community programs. The obvious current need for austerity has given impetus to some closing proposals. Virginia's layoffs are concentrated on such institutions. Connecticut's governor has proposed eliminating 180 employees at a Department of Mental Retardation training school and a recent report on how to save money in Connecticut recommends it be closed. Maryland's governor's proposals include closing a retardation institution. In a related action, Pennsylvania's governor has recommended closing several hospitals.

COMPARING EMPLOYEE BENEFITS

Introduction: Employee pay represents a significant portion of state costs. That fact and the obvious employee interest in the subject give rise to many pay comparisons, such as those appearing in Issue 24. However, the pay appearing on an employee's pay stub and W-2 statement is by no means a complete reflection of state employee cost.

Most of the emphasis of the FY 1991 state austerity programs has been on eliminating employees (e.g., hiring freezes and layoffs) or implicitly cutting their pay (by mandatory furloughs) rather than on non-wage elements of compensation. But some attention is focusing on employee benefits. For example, a Connecticut commission on cost savings recently recommended that the state pay 80% rather than 100% of health benefits and reconsider the 35-hour work week. Reducing the state's cost increase for existing health plans was a part of the Washington governor's budget recommendations and will probably be included in many others.

Calculating Per Hour Costs: The actual employer costs for a state employee are indicated by the calculation shown in Table 5. The base pay number of $27,516 is the average pay of state and local workers in October 1989. The remaining calculations are approximations.

Table 5: Calculation of Per Hour Costs Of State Employee

Basis Of Calculation	Amount	Totals
Base Annual Salary	$27,515	
Payroll Tax Items (FICA, WC, and UC)	2,725	
Employer State Pension	2,200	
Employer Health Insurance	1,560	
Other Funded Benefits (e.g., life ins.)	300	
TOTAL, State Government Outlay		$34,300
Total Hours (40/week x 52 weeks)	2,080	
Minus Annual Leave	-146	
Minus Sick Leave	-107	
Minus Personal Leave	-8	
Minus Holidays	-89	
Minus Workweek Under 40 Hours	-29	
TOTAL, Hours Purchased		1,701
Price Per Hour, State Perspective		$20.
Price Per Hour, Employee Perspective		$13.

The employee simply taking the number of hours in a year and relating it to his or her cost will produce a cost of a little over $13 an hour. But from the employer's perspective the cost is a considerably higher $20 an hour. The difference lies in the two categories on Table 5, employer cash outlays that don't appear in the employees' paychecks and the time paid but not worked. A new survey sheds considerable light on both categories of cost.

Health Insurance: The average monthly state costs for health benefits of a single employee (no dependent coverage) from a survey by Workplace Economics, Inc. appears on Table 6.

The data underlying Table 6 present problems for some states. In some health insurance contracts, the rate charged for individual policies is the same as for family policies, reflecting a decision by the state to cover part of the higher costs of family coverage in the price of individual coverage. In Table 6, such a state -- Washington is an example -- will show high costs for individual coverage. Also, it should be remembered that the costs shown are state government costs. Some of the states with apparently low costs have substantial employee contributions to the costs of health coverage, while many states don't require an employee contribution for individual coverage. Nonetheless, the table reflects the wide range in costs of employee health care which the states are accepting. In general, the high spending states (total state and local spending per capita) tend also to have high costs for employee health coverage, though there are many exceptions.

Table 6: Monthly State Cost of Individual Employee Health Benefit, 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$386	18	Wisconsin	$132	34	Ohio	$106
2	Washington	283	19	New Jersey	132	35	Arkansas	106
3	Oregon	236		**U.S. Average**	**130**	36	Missouri	105
4	Pennsylvania	212	20	Texas	130	37	Kentucky	103
5	Alabama	195	21	Rhode Island	128	38	Oklahoma	102
6	Massachusetts	178	22	South Carolina	121	39	Wyoming	100
7	Nevada	168	23	Utah	120	40	Illinois	100
8	Michigan	163	24	California	119	41	Florida	98
9	New Hampshire	162	25	Minnesota	118	42	New Mexico	85
10	Maine	159	26	Idaho	118	43	West Virginia	84
11	Connecticut	158	27	Georgia	116	44	South Dakota	80
12	Maryland	150	28	Indiana	113	45	Colorado	79
13	New York	144	29	Vermont	112	46	Mississippi	72
14	Arizona	144	30	Virginia	110	47	Nebraska	72
15	Montana	144	31	North Dakota	110	48	Tennessee	70
16	Delaware	142	32	North Carolina	108	49	Louisiana	60
17	Iowa	138	33	Kansas	108	50	Hawaii	48

Employee Days Off: The states are contrasted by the number of days they allow off each year in Table 7. Eight states allow six or more days above the national average. At $20 an hour, eight hours a day, six days represents nearly $1,000 a year per employee.

Table 7: Scheduled Days Off In A Year, 1990 Benefit Plans
Includes Annual Leave, Sick Leave, Personal Days, and Holidays

Rank	State	Days	Rank	State	Days	Rank	State	Days
1	Hawaii	55.0	17	Tennessee	44.0	34	New Hampshire	42.0
2	Alaska	52.0	17	Iowa	44.0	35	Arkansas	41.0
2	West Virginia	52.0	17	Maine	44.0	35	Indiana	41.0
2	Maryland	52.0	17	Nebraska	44.0	35	Oregon	41.0
5	Georgia	51.0	17	Nevada	44.0	38	Kentucky	40.5
5	Louisiana	51.0	17	Virginia	44.0	39	Utah	40.2
5	Massachusetts	51.0		**United States**	**43.9**	40	Arizona	40.0
8	Vermont	50.0	24	Florida	43.5	40	California	40.0
9	Rhode Island	47.0	24	Michigan	43.5	40	Montana	40.0
10	Minnesota	46.8	24	Ohio	43.5	40	Texas	40.0
11	New York	46.5	27	Mississippi	43.0	44	North Dakota	39.5
12	New Jersey	46.0	27	Oklahoma	43.0	45	Idaho	39.0
13	Alabama	45.5	27	South Dakota	43.0	45	Kansas	39.0
14	Connecticut	45.0	30	North Carolina	42.8	45	Washington	39.0
14	Delaware	45.0	31	Pennsylvania	42.6	45	Wyoming	39.0
14	Missouri	45.0	32	Wisconsin	42.5	49	Colorado	38.0
17	Illinois	44.0	33	South Carolina	42.2	49	New Mexico	38.0

Annual Leave And Holidays: A case can be made that state government discretion is most clearly expressed in decisions on holidays and annual leave. Not all the sick leave specified in Table 7 above is used, although most states eventually pay for unused sick leave through retirement credits or payments upon termination. Most holidays are standard in state government and the private sector, but there are some unusual ones. Massachusetts' new governor has reportedly decided to try to eliminate Patriots Day, Evacuation Day, and Bunker Hill Day. The annual leave for an employee with ten years service and number of days of holidays is shown on Table 8.

Table 8: Days Per Year For Annual Leave and Holidays
State Governments, 1990

Rank	State	Annual Leave	Holidays	Rank	State	Annual Leave	Holidays
1	Alaska	24	13	26	New Hampshire	18	12
2	Mississippi	24	10	27	Arkansas	18	11
3	Minnesota	22.8	11	28	Oregon	18	9
4	Hawaii	21	13	29	Kentucky	18	10.5
5	West Virginia	21	13	30	Arizona	18	10
6	Georgia	21	12	31	Montana	18	10
7	Louisiana	21	9	32	North Dakota	18	9.5
8	Tennessee	21	11	33	Idaho	18	9
9	Maryland	20	14	34	Kansas	18	9
10	Massachusetts	20	13	35	Wyoming	18	9
11	New York	20	12	36	Colorado	18	10
12	Nebraska	20	12	37	Illinois	17	12
13	Ohio	20	11	38	Michigan	17	12
14	Indiana	20	12	39	Wisconsin	17	9.5
15	North Carolina	19.8	11	40	South Carolina	16.25	11
16	Alabama	19.5	13	41	Utah	16.25	11
17	Florida	19.5	10	42	Washington	16	11
	U.S. Average	**18.3**	**11.2**	43	Pennsylvania	15.6	10
18	Vermont	18	14	44	New Jersey	15	13
19	Rhode Island	18	10	45	Connecticut	15	12
20	Delaware	18	12	46	Iowa	15	11
21	Missouri	18	12	47	South Dakota	15	9
22	Maine	18	12	48	Texas	15	13
23	Nevada	18	11	49	New Mexico	15	10
24	Virginia	18	11	50	California	14	13
25	Oklahoma	18	10				

Length Of Working Days: The scheduled 40-hour week is still standard for state government. But a dozen states have standard workweeks that are shorter. Workers get the best deal in Connecticut, New Jersey, and Rhode Island where the scheduled week is only 35 hours. The 37.5 hour workweek, five days at 7.5 hours, is standard in Alaska, Delaware, Illinois, Kentucky, New Hampshire, Pennsylvania, South Carolina, Tennessee, and West Virginia.

WAR AND STATE FINANCES

War Impact: State officials have been putting caveats on their revenue forecasts like "assuming no Middle East war." But what happens to states now that there is a war? There seems to be agreement on a few points.

(1) The successful termination of the war would produce significant economic stimulus because of falling oil prices and rising consumer confidence.

(2) If the war were to produce significantly higher oil prices, which experience to date suggests it will not, there would be a significant drag on economic growth.

(3) Unlike the Vietnam and Korean conflicts, the war will not produce a sudden surge of new orders for munitions or military equipment. The initial extra out-of-pocket costs are associated with relatively small specialized purchases (e.g., clothing and medicines to deal with chemical warfare), travel and fuel costs, and pay of reservists called to active duty. As a result, the inflationary stimulus of the war will be much less than previous U.S. war experiences.

Looking beyond immediate impacts is hard. As Federal Reserve Chairman Greenspan told a Congressional committee in late January, "Assessing the economic outlook is especially daunting at the present time." OMB Director Darman put it more dramatically:

> What is unusual about this situation is you have the possibility of extremely high deficits combined with a financial system under very significant stress combined with the potential for significant international destabilization. All three at once. One would be a fool not to take the confluence of those three as something extraordinarily serious to have to deal with.

The war's impact will mostly be felt through the federal budget deficit, rather than in immediate impacts of procurement. The large numbers being used for the cost of the war, such as half a billion to a billion dollars a day, won't necessarily translate directly into additions to the deficit. An unknown part of the costs will be paid by other nations. An unknown part of what is left represents costs of weapons systems that will not be replaced. OMB's current view is that the long-term outlook remains one of a decline in defense spending.

This leaves two implications for states. First, it is unlikely that there will be massive stimulus from the war. Second, the war will contribute a significant, but unknown, amount to the federal deficit. Besides the arguable impacts of this on the economy, it won't improve prospects for federal funding of domestic programs.

A presentation on the budget outlook at the National Conference of State Legislatures' fiscal chairs session, NCSL's recent budget report (The Federal Budget For 1991: Impact On The States), and the information from OMB and the Congress suggest federal fiscal relief for states cannot be expected. The deficit estimate was recently upped by $50 billion, implying new federal borrowing this year of about $3,000 for every American worker. Neither this -- nor even higher deficits from the Gulf War, more bank bailouts, or worsening recession -- will cause current year program cuts affecting states. Unlike the states, the federal government doesn't consider spending reductions when revenue drops below expectation. But there is little serious interest in spending increases for domestic programs of interest to states.

Governor Schaefer was under more pressure to deal with the impact of war on state policy than most state officials because his state-of-the-state address to the Maryland legislature was delayed 20 minutes while the audience watched the President's January 18 news conference on the Gulf War. In his speech, the governor commented:

> You are here at a very special time, really a special time. People are apprehensive. People are worried. They are worried over the economy, loss of jobs. Most of all they are worried about their loved ones and what is going to happen in the war. We must keep the ship of state sailing full sail during this critical time. It is important that we not succumb to melancholy paralysis. We must be prepared when peace is restored... We must take care of people now.

The number of National Guard and Reserve forces called up from each state isn't necessarily proportional to population. An argument can be made that a large call up is unfair by disproportionately subjecting state residents to economic hardship and the risk of battle. On the other hand, a case can be made that having a high call-up rate is desirable as indicating disproportionate numbers of state residents with appropriate skills and readiness and a tribute to state-managed Guard units. Governor Roemer of Louisiana has apparently been on both sides of this question, which most state officials haven't addressed. For what it is worth, estimates on the call-up to population ratio for the highest and lowest states are shown on Table 9.

Table 9: Forces Called For Gulf War Per 100,000 Population

Rank	State	Number	Rank	State	Number
1	Mississippi	281		**United States**	51
2	Wyoming	234	46	Connecticut	17
3	Louisiana	209	46	Oregon	17
4	Alabama	142	48	Idaho	11
5	North Dakota	135	49	Hawaii	4
6	South Carolina	132	50	Alaska	0

Many states have already acted to do something for those fighting in the Gulf by waiving certain tax filing deadlines. Despite the state's fiscal problems, the Massachusetts speaker and Senate president are seeking legislation that would give a state bonus of $500 to every resident serving in the Gulf and a $300 bonus to Guard and Reserve personnel called up for the crisis, regardless of where they served.

MISCELLANY

Drug Abuse Programs: The Office of National Drug Control Policy (Executive Office of the President, Washington, DC 20500) recently issued a kind of report card on state drug control activities, State Drug Control Status Report. William Bennett, then drug czar, provides an introduction which stresses the role of the states in dealing with drug abuse. The report endorses a variety of state laws. It suggests that states may be able to achieve the objectives by other means, but then says, "Each State can and should be expected to adopt the laws and policies addressed in this report, tailoring them to fit its particular circumstances." The report contains a pull-out chart showing which of the 50 states have adopted each of 18 policies. The results (summed by **Reports**) appear in Table 10.

Table 10: Number of Policies To Control Drugs Adopted, 1990

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Florida	14	16	Georgia	10	34	Idaho	7
1	Oklahoma	14	16	Illinois	10	34	Kentucky	7
3	Colorado	13	26	Indiana	10	34	Mississippi	7
3	Michigan	13	21	Delaware	9	34	Montana	7
3	Minnesota	13	21	Hawaii	9	34	Ohio	7
3	Rhode Island	13	21	Kansas	9	34	Oregon	7
7	New Jersey	12	21	Maine	9	34	South Dakota	7
8	California	11	21	Massachusetts	9	42	Arkansas	6
8	Louisiana	11	21	Nebraska	9	42	New Hampshire	6
8	Maryland	11	21	Pennsylvania	9	42	Washington	6
8	Nevada	11	21	Texas	9	45	Alaska	5
8	South Carolina	11	29	Iowa	8	45	North Carolina	5
8	Tennessee	11	29	Missouri	8	45	West Virginia	5
8	Utah	11	29	New Mexico	8	45	Wyoming	5
8	Wisconsin	11	29	New York	8	49	North Dakota	4
16	Alabama	10	29	Virginia	8	50	Vermont	3
16	Arizona	10	34	Connecticut	7			

The average state has adopted about 8.9 of these policies. There are substantial objections to some of them. For example, the policies on seizure of assets and eviction from housing raise civil liberties issues. A policy of giving seized assets to law enforcement agencies, rather than making them general assets subject to appropriation, raises budget process concerns in many states. For example, Missouri's forfeiture law was challenged in court by a group of school districts. In December, the Missouri Supreme Court ruled that the forfeitures fell within the constitutional provision that forfeitures and fines go to the schools. {Missouri law enforcement officials can avoid the state rule by combining drug bust operations with federal officials and taking a local cut under federal law.}

Financial Institutions Regulation: Governor Sundlun has a plan for dealing with the problem Rhode Island financial institutions that haven't obtained federal deposit insurance. He is proposing a "Depositors Economic Protection Corp." which would assume the assets of the closed institutions. Preliminary estimates indicate that the corporation would have about $1.3 billion in liability to depositors and assets falling about $150 million short of covering that liability. Some of the institutions are looking for ways to preserve their autonomy.

The governor wants to delay some state payments to depositors until 1993. But depositors aren't going to like such a decision and legislators may not either. To deal with this problem, the governor is said to be considering state borrowing and/or issuance of promises to pay (scrip) to depositors. The estimated $150 million liability linked with an estimated deficit of $160-200 million in the $1.5 billion state budget to trigger a decision by Standard & Poor's to put the state on CreditWatch.

The Rhode Island case (and perhaps others to come?) suggest the ease with which state governments can ignore contingent liabilities. The Rhode Island situation was described this way in a report by the state's own regulators:

> The existing Rhode Island situation should be tolerated no longer. To allow $1 billion in deposits of some 300,000 persons to be held by financial institutions with no Federal insurance is archaic and dangerous. Some of these institutions ... are in serious financial condition and very probably insolvent. RISDIC, at best, is a highly questionable insurance fund without reinsurance and without reserves for potential losses. When the anticipated run occurs, RISDIC will be fortunate to cover $15 million -- less than 2% of the risk which it purports to insure. As stated, RISDIC will perform no better than the state-sponsored funds which recently failed so completely in Nebraska, Ohio, and Maryland. This is an inherited situation. Yet, as the Maryland experience confirms, the Rhode Island public and the financial community will judge harshly any failure to deal with it decisively and effectively.

The report was presented in 1985. So were the many accounts in **Reports** and elsewhere indicating what happened in Maryland, Nebraska, and Ohio and what some other states did to avoid similar problems. There are four after-the-fact probes already announced in Rhode Island: (1) a group appointed by the governor to be headed by the president of Brown University, (2) a group operating under the auspices of the House Judiciary Committee to be headed by an out-of-state lawyer experienced in banking, (3) a special committee of the Senate, and (4) a probe involving ten people working for the attorney general.

Some of the other 20 states that permit credit unions to operate without federal insurance are moving to ensure that their institutions obtain federal coverage. Florida institutions are applying at the urging of state regulators. In Texas, the governor has asked regulators to take the same action. Missouri's legislature is holding hearings on a measure to require the state's credit unions to obtain federal insurance.

Six New England governors met with FDIC chairman William Seidman to express their concerns that federal regulation was unnecessarily creating a capital crunch that was damaging the New England economy. They got some assurances, but nothing specific. In his inaugural address, Governor Gregg (R-NH) called the banking crunch a greater problem than either recession or the state's budget woes.

The Middle Class Suffers, Another View Of Budget Cutting: "Are the state budget cuts being concentrated on the middle class?" An editor from U.S. News raised this interesting theme in interviewing **Reports** editor Hal Hovey, who wasn't sure of the answer at the time and still isn't.

An empirical answer to the question presumes that the beneficiaries of state spending can be identified with the same precision by which tax experts predict the burdens of taxes on various income groups. The trend in state spending has probably been toward spending for lower income groups. The big winners in spending, measured by percentage increases, have been Medicaid and corrections. The big winner in total dollar increases has been elementary and secondary education. There is room for considerable debate over what income group benefits most from these programs. If the beneficiaries are those for whom money is spent, then Medicaid recipients, prison inmates, and school children are the winners -- with lower income groups disproportionately represented in all three cases. But those paid with state dollars -- health care professionals, corrections officers, and teachers -- are middle class and above.

Probably the three state activities most clearly concentrating benefits on the middle class are: (1) higher education, (2) state aid to local government that holds down local property taxes, and (3) parks and recreation. Higher education is clearly bearing a larger share of budget cutting than its share of the budget, with some of the effect appearing as tuition increases. Quantification is harder, but local aid appears to be bearing a larger share also. Parks and recreation is consistently impacted by across-the-board cuts, hiring freezes, and purchasing constraints that often exempt other state activities such as corrections and aid for public schools. So it is probably true that the cuts disproportionately affect the middle class. Whether this is a good result or a bad one is, of course, a value judgement.

The subject isn't discussed in most states, but Governor Weld has been talking about it in Massachusetts. He is deliberately trying to cut what he calls "middle class entitlements." His usual example is Medicaid-paid nursing home benefits for higher income persons, particularly those who keep their homes under state law, divest their other assets by giving them to relatives, and qualify for Medicaid rather than relying on their own resources or those of their families.

Pay Raises: Some states have procedures that make pay changes for elected officials between November elections and the swearing in of a new governor and legislature. By voter action in June (Proposition 112), a citizens' commission sets the pay for the California governor and legislators without any action by them. Legislators will get a pay raise to $52,500 (from $40,816) while the governor's pay goes to $120,000 from $85,000.

Florida's new governor announced that key staff aides would be getting $98,000, up about 15% from the prior administration. With the state employee pay increase this year about 3% and new taxes likely, the decision drew some criticism. In Pennsylvania, the governor gets a $20,000 raise, to $105,000 a year.

Personal Income: Like most economic statistics, the state personal income estimates are revised by the federal government after they are issued. The statistics, often before revision, are used for federal aid distributions, to calculate state tax burdens, for **Reports**' Index of Economic Momentum, and other purposes. In the December Survey of Current Business, there is an extensive discussion of why revisions are made and the impacts they have.

Research And Development Spending: State officials continue to place considerable importance on attracting R&D funds. The role of university research is viewed as having been and continuing to be substantial in states such as California, Massachusetts, and North Carolina. Looking only at total science and engineering R&D, a few states get the bulk of the money. Of a national total of $14.7 billion in FY 1989 R&D spending, universities in California accounted for $1.8 billion, followed by New York ($1.3 billion), Texas ($1.0 billion), Maryland ($922 million), and Massachusetts ($868 million). But when the data are recalculated on a per capita basis as in Table 11, some of the smaller states are doing fine.

Table 11: Per Capita Science And Engineering R&D At Universities, FY 1989

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Maryland	$192.1	18	Arizona	$60.6	34	Louisiana	$42.3
2	Massachusetts	143.9	19	Nebraska	59.2	35	Virginia	41.6
3	Alaska	102.7	20	Texas	59.1	36	Indiana	40.8
4	Utah	95.4	21	Minnesota	58.9	37	Montana	40.3
5	New Mexico	89.5		**United States**	**58.6**	38	Ohio	38.3
6	Connecticut	86.3	22	Washington	56.6	39	New Jersey	36.5
7	Rhode Island	79.3	23	Oregon	56.4	40	Oklahoma	35.9
8	Vermont	75.6	24	New Hampshire	55.8	41	South Carolina	34.2
9	Iowa	75.1	25	Delaware	55.6	42	Idaho	32.8
10	New York	73.8	26	Illinois	52.7	43	Florida	29.6
11	Wisconsin	68.6	27	Michigan	52.1	44	Mississippi	29.1
12	Colorado	68.4	28	Wyoming	51.1	45	Nevada	28.3
13	Georgia	64.1	29	Alabama	51.0	46	Kentucky	22.7
14	North Carolina	63.9	30	Missouri	49.6	47	West Virginia	21.9
15	Pennsylvania	63.8	31	Tennessee	43.9	48	Arkansas	18.5
16	Hawaii	63.4	32	Kansas	43.4	49	South Dakota	17.7
17	California	61.8	33	North Dakota	43.0	50	Maine	16.2

School Governance: Illinois' sweeping attempt to reform Chicago schools by decentralizing control has run into problems. At the end of November, the state supreme court rejected the governing arrangement with its 6,000 elected members of school councils. The council members are elected by their own group -- teachers electing teachers, parents electing parents, etc. The court found that the parents are overrepresented by one-man-one-vote criteria. After considering several remedies in January, the Illinois legislature gave Chicago's mayor appointive authority in an attempt to preserve the legality of the selections. The legislature will likely revisit Chicago school governance in the 1991 session.

New York has a special state commission on school governance examining the effects of the 20-year old decentralization of New York City schools. The group is likely to recommend giving the mayor more control.

State Issues: The National Conference of State Legislatures (1560 Broadway, Denver, CO 80202) has issued its annual volume (State Issues 1991) summarizing a survey of state legislators and legislative staff on top legislative priorities in each of 18 areas such as agriculture, the arts, children, and education.

Voter Turnout: There are two sets of statistics on voter turnout. One simply relates the votes counted by election officials to population, but this method doesn't permit analysis of turnout differences by age, race, income, sex, or other personal characteristics. To learn about such differences, the Census Bureau interviews people on whether they voted, but the results don't square with counts by election officials. In addition, there are disputes over what population statistics should be related to the voting statistics. For details see a new Census publication, Studies In the Measurement Of Voter Turnout.

TECHNICAL NOTES

Budget Balancing: The shortfalls in current (FY 1991) state budgets have been compiled by the National Association of State Budget Officers from estimates of executive budget offices and by the National Conference of State Legislatures from estimates of legislative fiscal officers. The 50-state results are compared in State Budget & Tax News (Issue 1). The NASBO report included the tabulation of strategies in effect or under consideration for budget balancing shown as Table 1.

Massachusetts Budget: The Federal Reserve Bank of Boston (600 Atlantic Ave., Boston, MA 02106) study is Massachusetts In The 1990s: The Role Of State Government by Alicia Munnell and Lynn Browne. They were assisted by others on the Bank's staff including Robert Tannenwald, who summarized some of the conclusions at NCSL's fiscal chairs seminar in January.

The study suggests the "indexing" of bonds. The face value of the bond, and thus the annual interest payment, would rise with inflation. As an example, the study uses a 5% inflation rate and 2% real interest rate. Instead of paying 7% interest, the state would pay 2% on the ever escalating value of the bond. Relative to a normal bond, the plan would postpone much of the debt service cost. The Bank's staff considers this appropriate, better reflecting the timing of project benefits. The Bank's staff recognized the problem with this, but not the alternative. The problem is that interest paid by Massachusetts is exempt from federal income taxes, but the capital gain on the bonds would be taxable. The alternative is to spread debt service toward the later years of a bond issue by the schedule of maturities and interest payments. State bond issues often have level principal and interest payments like a mortgage, but other options are available.

The mental retardation study is Mental Retardation Programs: How Does Massachusetts Compare? It was published by the Pioneer Institute (1105 Commonwealth Ave. Boston, MA 02215). After heading the Massachusetts budget agency, Moscovitch headed DRI activities that provide econometric estimates used for revenue forecasting in many states.

Employee Benefits: The data in this section are from 1990 State Employee Benefits Survey which was developed by Workplace Economics, Inc. (P. O. Box 33367, Washington, DC 20033). The full survey contains 95 pages including detail on benefits, such as education plans and child care, not reported in this review. There are periodic surveys of compensation for particular state functions. An example is American Association of State Highway and Transportation Officials, 1988 Survey Of Fringe Benefits For Highway And Transportation Department Employees.

The provisions of state compensation systems are complex and in some states vary from bargaining unit to bargaining unit. For example, Maryland is not listed as one of the states with workweeks below 40 hours, but in January the governor issued an executive order requiring a 40-hour week that the attendant publicity indicated would affect 40,000 employees who work 35.5 hours a week.

To provide the summary in the text, **Reports** exercised some discretion in ignoring footnotes or adjusting data for them and in providing averages when ranges were indicated. The data on annual leave and, where it relates to longevity, on sick leave, are for an employee with ten years of service. The cost of health plans include dental plans where they are provided. The averages shown on the tables are unweighted averages of the 50 states.

Some of the states reporting a workweek shorter than 40 hours indicated that some of their employees work longer workweeks than the state average. Presumably some of these states have retained the 40-hour week for shift workers, like nurses and prison guards.

War And State Finances: The call-up data were initially published by the Omaha World Herald in early January and picked up elsewhere, including the Washington Post (1/11), which is the source of Roemer's statements on the issue.

Financial Institutions: The Providence Sunday Journal (1/6) traced the background of the Rhode Island problems, including the memorandum quoted. It was made available to the governor and the legislature.

Research and Development: The national R&D figures deal only with doctorate-granting universities, where most of the university research takes place. They come from the National Science Foundation and were reprinted in the Chronicle of Higher Education (1/16). **Reports** used 1990 population to make the calculation shown in the article.

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February 1991 (Second of Two February Issues)

COST-CUTTING THEMES

Introduction: The pressures on state budgets are producing some common budget-cutting responses. There are systematic differences between what is being done to restore balance this year (FY 1991) and what is being proposed for next year (FY 1992).

Shortfalls Common: There are at least 30 states with shortfalls in the current year that are triggering cutbacks. For next year, nearly every state's budget is tight by historical standards. Defining how many states have shortfalls is difficult because definitions of shortfalls in future budgets vary from state to state. For example, some states will define a shortfall as occurring if funds from existing taxes are insufficient to provide inflation-matching pay increases for state employees and teachers. Others won't call the situation a shortfall unless they can't afford to maintain current pay levels.

Current Year And Budget Year Cuts: The options in reducing current year spending are different from those available in the budgets for next year. School districts, cities, and counties are in the midst of their own fiscal years. Their budgets are set and many of their personnel, particularly teachers, are under contract. Often their revenues are also set by previous decisions on property tax rates. There are limits to the changes that these governments can make on short notice. These same considerations also affect state universities. This limits the size of cuts that can be made in the current year in aid for public schools, universities, and local governments. As a result, cuts have been concentrated on the state's own operations. This explains the high concentration on furloughs for state employees, freezes on hiring and purchases, and similar actions.

The lack of flexibility to make current year cuts sometimes is discovered after governors have announced cuts. When the practical problems and the strong opposition appear, the cuts sometimes aren't made. In some states, such as Maine and Michigan, the difficulties appear in the legislature. In Maryland, the governor has been dropping many of his announced cost saving measures, without legislative involvement. The latest was a 40 hour week. He previously rescinded announced layoffs of 1,800 workers. He commented, "everywhere we try to make a reduction, that's the one that cannot be touched."

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Recognition of the limits on flexibility to make current year cuts explains the strong interest in measures that aren't true spending cuts -- borrowing money from other state funds, delaying expenditures, and accelerating revenues.

Cuts In the FY 1992 Budgets: In the governors' budgets for FY 1992, there are many more options for budget balancing. The simplest strategy is avoiding increases in nearly every spending category. For most states, such a strategy avoids a tax increase if the current year budget is balanced. Revenue goes up by about the sum of predicted inflation (roughly 5%) and predicted real GNP growth (roughly 0-2% depending on the estimator). This 5-7% increase covers even double digit increases in Medicaid and corrections, which are often considered uncontrollable, leaving little or no growth in anything else. The consequences are no increase in school aid and state-supported teacher pay, no state employee pay increases, freezing aid to cities and counties often contrary to state statutes on sharing of revenue, and avoiding any new initiatives including ones like educational quality programs previously enacted. These consequences are sufficiently severe so that some states will probably see tax increases even though elected officials are now vowing to avoid them.

Specialized Cuts: There are a few special forms of cuts that are proving popular in this year's budget proposals. All are controversial. They are: (1) reducing support of local government, as discussed in the next article, (2) making college students pay a larger portion of their costs, (3) shifting from institutional care to community care in mental health and retardation programs, and (4) reexamining state provision of services usually provided by the private sector.

Making College Students Pay More: Higher tuition has been on the agenda of most states for the past several years. Fiscal problems have increased interest in tuition increases, particularly in two states, California and New York, with traditionally low tuition.

After forgoing tuition increases for many years in the state system (which includes the New York City system that was formerly free), New York moved far enough toward an increase several years ago to trigger student occupation of some buildings. The state backed down, leading to a record of seven years without increases. But in December, a tuition increase was adopted, raising the State University of New York (SUNY) tuition $300 to $1,650 a year. The governor's budget for FY 1992 would hike tuition at SUNY by $500 as well as limit a widely used state tuition assistance program. Angry student reaction is expected.

The fiscal emergency plan announced by Massachusetts' new governor would essentially eliminate state student financial aid, converting existing programs to loans. It also reflects a 33% increase in higher education tuition. The governor didn't recommend college closings, which were rumored, but did recommend that the Board of

Regents and the state Board of Education be merged into a single secretariat.

Tuition, which is a relatively recent phenomenon in California, has been rising and will rise even more under the governor's recommendations. The new state budget for the University of California involves essentially no change in state subsidy, with spending increases to come from a 20% hike in student fees. Besides objecting that there was no general fund money for faculty salary hikes or enrollment growth, the UC president pointed out that the budget was based on optimistic economic assumptions, so the university system might be faced with further financial difficulty and uncertainty.

Even if it had received the amounts it requested from the state, the University of Vermont would have raised tuition for state residents by 9.5% to $4,600 a year and out-of-state tuition by 5.1% to $13,450. But even in the context of a budget based on higher taxes, the governor recommended reducing state aid for the university by 5%. In that case, university trustees are looking for an in-state tuition increase of nearly 17%, to $4,900.

The American Association of State Colleges and Universities has tallied mid-year budget reductions affecting state institutions in at least 23 states. The group expects more before the fiscal year is completed. For FY 1992, two-thirds of the responding higher education officials expected that their state's condition would be worse than in FY 1991.

Shifting From Institutional To Community Care: Governor Weld has indicated he will be seeking legislative authority to close several Massachusetts public health and mental health institutions. Apparently he wants to get authority without naming the institutions in advance. In Maine, the governor's budget calls for a substantial scale back of state-run nursing home and mental health facilities. Oregon's budget includes closing mental health wards, but not institutions. Michigan's budget plans include closing four facilities.

Shifts won't be a money saver in New Mexico which has just lost an elaborate court case on the developmentally disabled. Unlike cases in other states involving primarily a single institution, the case recently decided in a U.S. district court involves both institutional and community care. It will produce some movement out of institutions, but will be cost increasing overall because of costly improvements in both institutions and community care.

In Pennsylvania, the state has closed the Philadelphia State Hospital and moved resources toward community programs. But there is reluctance to move further toward community care in the current budget environment. The impression is widespread that the community programs should be in place before savings occur in institutional programs. This view makes change a casualty of budget tightness.

Reexamining Services Usually Provided By The Private Sector: West Virginia has completed the process of selling its state retail liquor business, netting an estimated one-time revenue gain of $20 million. Iowa sold its liquor monopoly in the 1980s. From the end of Prohibition until these sales, 17 states were in the liquor business. In Maine, the governor proposes to close ten state-operated liquor stores. They would be replaced by "agency stores," which are franchised private operations. The Massachusetts budget proposal involves privatizing ice skating rinks, several zoos, and pension fund investment management.

There are also some shifts that don't involve movement to the private sector, but have the same budget impact. New Jersey's budget achieves balance in part by sale of $400 million of existing state highways to the turnpike authority -- a page taken from last year's New York budget-balancing book.

Long Term Perspective On Cuts: It can be argued that in selecting the kinds of cuts they are making, state officials are displaying too much of a tendency to think short term. As Vermont Governor Snelling put it in an interview at the February NGA meeting:

> We won't always have a war, and the recession won't last forever. So what are we going to do when we have some resources again? Is anyone thinking about that? No, we're all mesmerized .. by who pays for this or that and we're not thinking about opportunities for the future.

Snelling has proposed that Vermont cope with its fiscal situation by major "temporary" increases in state taxes, including both the sales and income tax.

REDUCING LOCAL AID

Introduction: Many local officials are complaining that they are bearing the brunt of budget cutting at both the federal and the state level. Their assessment of federal impacts is unquestionably accurate. Federal aid expansion is occurring in programs of aid to states, particularly Medicaid and other income-tested programs. Federal aid cutbacks have been concentrated on programs where aid is provided directly to local government. The situation regarding state aid varies from state to state. However, state decisions appear to be favoring education, and thus school districts, rather than other functions, and thus cities and counties. In states without separate school districts, primarily New England, all local aid is being affected by severe state fiscal problems.

Reducing Local Aid: The local aid reduction strategy has been particularly strong in New England. New Hampshire has already taken local aid to about the irreducible minimum. It eliminated all school equalization aid last year except what could be funded with lottery proceeds. Massachusetts has been cutting local aid while expanding state-administered programs like Medicaid. Several advisory panels have recommended more of the same. So has a Blue Ribbon group in Connecticut. Key legislators have advised local officials to expect state aid to be frozen this year. The governors of New York and California have recommended reducing aid. In New York, the governor is suggesting a reduction in mandates. In California, the governor has suggested legislative approval of higher local taxes.

Many states have programs that relieve the burden of local taxes by providing some sort of relief directly to taxpayers. The circuit breaker, which reduces income taxes based on property taxes paid by certain taxpayers is an example. These also are budget cutting targets. Before he left office, Governor Deukmejian suggested restricting the California renters' credit, a suggestion endorsed by Governor Wilson's budget. The Maine legislature is considering proposals to cut property tax relief programs. These developments suggest that the prediction of ACIR's fiscal expert Robert Ebel -- "pressures on county budgets are likely to increase during the 1990s" -- will be true.

The Local Concern: The executive director of the National Association of Counties reflected what is happening in many states in a recent article:

> Today, the states are being forced to address their own fiscal dilemma. Expenditures for continued programs are projected to outpace revenues. In an anti-tax mood, state solutions, with a few notable exceptions, tend to mirror the actions of the federal government. There is, therefore, little or no attention given to the financial impact on local governments.

He makes the case of greater revenue flexibility for local governments. This is not just an issue of whether state law permits local sales or income taxes, but also covers a variety of fees and charges. He also observes that state laws often restrict the tax base of some taxes, particularly the property tax, because of state exemption rules. There are, of course, two sides to this story. Illinois home rule local governments set their own tax base for the sales tax. They could, and did, tax sales not taxed by the state and not each taxing jurisdiction used the same list. Responding to business complaints about administrative costs, the Illinois legislature harmonized the base. Exactly the same move for the same reasons is on the Colorado agenda this year.

Recognizing The State Role: The critical role of the state -- in granting taxing authority, in providing aid, and in establishing mandates -- was recently discussed by Tanis Salant:

> Recent surveys of county officials, legislative hearings in state capitols, and a growing body of literature point to the relationship with the state as the most critical component of county viability. Insufficient revenues have become the biggest headache for county officials, and the spiraling costs of state-mandated programs, particularly those for indigent services and long-term health care, are cited as the primary cause. Those mandates are handed down without accompanying funds, or sufficient funds, to finance them, and client-driven state formulas keep costs beyond the control of counties. Unfunded state mandates are now widely recognized as unworkable, especially in light of the restricted revenue-raising capacity of counties, and many states are searching for alternatives.

The State-Local Dialogue: There is no more likelihood that states and local governments will reach agreement on their relative roles and financing than that the federal government and the states will do so. In both cases, the lower level of government speaks with many voices. So does the higher level. So legislators or the Congress may agree on a budget for assistance to the next level of government but disagree on what it represents. To some, it may represent a temporary adjustment to budget exigencies. To others, it may represent a step on the way to permanent realignment of relations among the levels of government. To increase understanding in these circumstances, some states have established intergovernmental relations commissions, often modeled after the U.S. Advisory Commission on Intergovernmental Relations.

Local Aid In Massachusetts: The governor's budget in Massachusetts proposes that local governments begin to pick up 10% of the costs of teacher retirement. Local governments would also take a cut of $271 million in aid. Massachusetts cities and towns are subject to the Proposition 2 1/2 property tax limit and have no authority to levy sales or income taxes.

Local Aid In Georgia: The Georgia budget cuts $28 million in grants to local government. The speaker told the Georgia Municipal Association, "The federal government is trying to balance its budget on the backs of state governments, and now, if we're not careful, we're going to balance our budget on your backs." The budget has triggered the expression of municipal concern that the state may be repeating a federal pattern of reducing money while increasing mandates. Concerns include: (1) environmental mandates such as waste water treatment, landfills, and drinking water, (2) the state growth planning mandates, (3) education reform measures, (4) training requirements for law enforcement personnel, (5) a legislative requirement passed last year that pubic safety and certain other municipal officials receive hepatitis shots, and (6) a mandate requiring local government to register dangerous dogs.

Local Aid In New York: Rhetoric over state and local fiscal responsibility is illustrated by the response to the governor's budget in New York. It has what can be construed as a 50% cut in state revenue sharing and a 10% cut in school aid. The local perspective, articulated by the head of the New York Conference of Mayors, is that the governor, "has given the appearance of dealing with the deficit without raising taxes, when in reality we've been forced to raise taxes repeatedly." One mayor (Olean, NY) commented, "Washington's doing it to the state and the state is doing it to the local communities." But, he complained, "I've got no one to do it to but my taxpayers." Governor Cuomo suggested that local officials "may have to suffer a little too." He argues that it doesn't follow that local officials have to raise taxes because the state cuts aid: "I cut $4.5 billion. Why can't they?"

New Local Revenue Sources: Shifting financial responsibility to local government has triggered interest in new local revenue sources. Some choices are obvious, like the new local option sales tax in South Carolina and the additional taxing authority the New York legislature is expected to approve for New York City. Some are less obvious, such as the creation of special taxing districts for downtowns, impact fees, tax increment financing, and more. The Indiana Fiscal Policy Institute summarizes many of these with the intriguing title, "Impact Fees And Other "Designer" Taxes: Alternatives To General Taxation."

EVALUATING STATE LEGISLATURES

Introduction: In early February, the Arizona legislature made national news with the indictment of seven legislators, along with lobbyists and others. The coverage included videotaped recordings showing legislators receiving illegal contributions in return for support of legislation to legalize casino gambling. The case is another example of the sources of public concern over legislatures.

Concern With The Legislatures: Dissatisfaction with state legislatures may have reached new highs. Whether or not this is true, action based on that dissatisfaction appeared in the November elections, when limitations on legislative terms and staffing were adopted in some states. New indictments of legislators in several states add to the pressures for reform. However, there is no simple assessment of what is wrong, so there are a multitude of suggested remedies each dealing with a different perceived problem.

The Sources Of Discontent: Measuring discontent with government, or even assessing whether it has changed over time, is tricky if not impossible. There is extensive public opinion polling data on voter impressions that come from answers to questions like whether people trust institutions such as government, media, and business, or professionals such as Members of Congress and doctors. These show constantly high levels of distrust and that respondents don't believe they control these institutions. For government, this shows in polls with many indicating they don't feel how they vote makes any difference. It also appears in election turnout, with high percentages of potential voters who don't vote.

A large segment of the population is disaffected because their policy views are so far from the prevailing wisdom that most current policy debates seem irrelevant. Those involved in state politics pay considerable attention to issues like whether taxes go up or down 5%, which tax is selected for increasing or cutting, and whether public schools get 2% or 5% more money. Issues like these are nearly irrelevant for those who believe the fundamental problem is racism, or that the water is being fluoridated, or that capitalism is the root of the nation's evils, or that government is two or three times as large and expensive as it should be. These groups can't be lightly dismissed, particularly if there is evidence that their numbers are growing. With a tax system dependent on voluntary compliance and clear evidence that no amount of spending on law enforcement substitutes for social controls, general disaffection is important, but not the subject of this article.

There is also substantial disaffection among groups who do vote, who campaign and give money to influence election outcomes, who themselves run for office or encourage others to do so, who run major corporations or organizations of employees, or institutions like universities and churches. One can't easily measure dissatisfaction by this group either, but there seems to be a lot of it. One standard poll question asks whether the country is now "off on the wrong track." When this question was asked in October, 59% responded it was on the wrong track while only 22% indicated it was "heading in the right direction."

Focus On Legislatures: Rightly or wrongly, most of the current informed criticism is focusing on legislative bodies, in particular state legislatures and the Congress. This is indicated by public opinion polls which consistently give executives, whether governors or the President, better performance ratings than the corresponding legislative body. This tends to be true regardless of what the hot issues are, what the parties' positions on the issues are, or the partisan affiliations of either the judges and those being judged.

For example, an October 1990 poll for the Council of State Governments (State Government News, January) indicated a 36% approval rating for the Congress, but a 65% approval rating for the President. A Media General-AP poll in September indicated 51% of the public believes that raising money for their next reelection campaign was more important to state legislators than passing good laws. The same slim majority thinks lobbyists have too much influence in state legislatures and 81% answered yes to the question, "Do you think state lawmakers sometimes vote the way lobbyists want them to in exchange for gifts from lobbyists?"

The California Poll in September asked a sample of Californians to indicate what kind of job they thought the state legislature was doing. The results were: excellent/good, 22%; fair, 47%; poor/very poor, 24%; and no opinion, 7%. The rankings were down from a comparable poll in 1988, but about the same as a comparable poll in 1983. A Michigan poll in October found 63% support for limitations on state legislative terms and 67% support for the statement, "It is time for Lansing politicians to step aside in order to make room for new leaders." Like other polls, it indicated support for one's own legislator accompanied by lack of trust in other legislators. An Arizona poll in August indicted 43% have little or no trust in the legislature, up from 35% in 1988.

Looking At Legislatures: Most of the academic and media attention devoted to American legislative bodies goes to the Congress. "State government has not been a fashionable field of study within the discipline" of political science "for some time," according to Alan Rosenthal, the Director of the Eagleton Institute at Rutgers. There are several recent attempts to remedy the situation, including Rosenthal's own 213-page contribution Governors & Legislatures: Contending Powers (Congressional Quarterly Press, 1990).

Rosenthal is convinced that the balance of executive-legislative relations has shifted in recent years toward the legislature. Rutgers and Rosenthal may have had something to do with this as the Eagleton Institute pushed "legislative reform" in the late 1960s and early 1970s. "Reform" in that context meant more inputs -- more staff, more time on the job by legislators by higher pay and more frequent and longer sessions. These criteria found their way into rankings of legislatures by the Citizens Conference on State Legislatures, which, Rosenthal comments, "had a profound political impact" with many legislatures trying to raise their rankings. At a Symposium on the Legislature sponsored by Eagleton and NCSL in April 1990, participants pointed to progress in the legislatures on such subjects as representativeness, capacity to deal with issues, "democratization," professionalism of legislators, and legislative roles in policymaking.

Legislative Reform In Maine: The ideas of those earlier studies are still appearing as recommendations in individual states, just as Eagleton itself brought its recommendations into states with special studies done in Arkansas, Connecticut, Florida, Maryland, Mississippi, Rhode Island, and Wisconsin. The latest example is a study that was done by Peat Marwick in its 120-page report for the Advisory Committee on Legislature Structure and Operations (staffed by the Maine Legislative Council, State House Station 115, Augusta, ME 04333). The study was the outgrowth of disputes between the Democratic-led legislature and the Republican governor over revenue estimates in late 1989 and early 1990. The original dispute is lost in history as both executive and legislative branch estimates proved much higher than actual revenues.

Peat Marwick concluded that "the Maine Legislature is generally well-managed, and benefits greatly from its commitment to a professional, non-partisan staff organization." The level and growth of legislative spending were found reasonable in relation to workload and patterns of other states. It recommended requiring a two-thirds vote of the legislators on the Legislative Council to avoid partisan votes when one party controls both houses and stalemates when control is split.

The study suggested strengthening of the legislature in "the development and administration of the legislative budget and the oversight of legislative expenditures." It also suggested improved use of legislative time. Like many journalists, legislators, and other studies, it bemoaned the legislature's tendency to adopt important legislation in the last days of the session. Many of the recommendations concern details of the relationship between the appropriating committees and authorizing committees and the establishment of appropriations subcommittees. Recommendations included ideas, such as expanding office space and an intern program, likely to increase the costs of the legislature and the number of people involved.

The report was issued last spring when the legislature was preoccupied with fiscal matters, so action on the major recommendations was saved for this year's session. The fiscal problems are even more serious than last year, so it isn't clear whether action will be taken on the report. The initial reactions varied from the Senate Minority Leader, who reiterated his view that the legislature spends too much, to an initial majority view that it was desirable to have a management study from time to time and that the recommendations would be considered in due course.

Are Legislatures Too Bureaucratic? Rosenthal devotes a section to what he calls the "congressionalization of the legislatures." He finds legislators are increasingly oriented to their jobs as a permanent occupation, and thus more interested in reelection prospects and spending time on fund-raising and dealing with constituencies and presumably less interested in the traditional work of forging legislation. He devotes a chapter to the relationships between governors and legislatures, using the sales tax on services in Florida, which was enacted and repealed, as an example of what not to do. The closing chapter is an exhortation to cooperation between governors and legislatures, stressing the point that both lose when conflicts are persistent.

The April Symposium on the Legislature identified problems in state legislatures. One was "congressionalization." Attenders rejected term limitations as a solution, but did endorse four-year terms "in order to reduce somewhat the disruptions of political campaigns to the legislative process." Another problem was campaign finance, on which the consensus was "something had to be done." But there was no consensus on what. The group, with some dissent, also suggested states avoid adopting the initiative process.

Ethics And Legislatures: Several prominent state legislatures, besides Arizona, had major concerns develop over ethics problems in the past year. No one keeps book on the subject, so the level of concerns may or may not be higher than in the past. Regardless, it is clearly substantial.

In California, a continuing FBI investigation produced its second major conviction -- former Senator Paul Carpenter who left his legislative post to become an elected member of the powerful Board of Equalization (which administers tax laws). The conviction raised important issues for all legislatures, as the crime did not involve taking money for personal use. The California Journal (10/90) commented:

> The second shoe fell in the on-going FBI investigation of the state Legislature, and it hit the ground with a thud that should shake everyone in the state Capitol. The conviction of former Senator Paul Carpenter differed from that of Senator Joseph Montoya in a couple of significant respects. The FBI money Montoya took went into his pocket, but Carpenter put his into his campaign account. The Carpenter verdict thus shows that juries will convict even if there is no personal gain. In addition, Carpenter never voted for the FBI bill, but he did admit that he gave the undercover agents "access." If juries are willing to send legislators to jail for selling access for campaign contributions, then we doubt there is a single member of the Legislature who isn't guilty. Indeed, it has often been the proud defense of lawmakers that they *only* grant access for the contributions they get.

In New York, House Speaker Mel Miller was indicted in December on fraud charges stemming from a real estate deal.

In South Carolina, an FBI investigation has produced indictments of 10 legislators, guilty pleas by five, and promises more to come. Some of the cases involve acceptance of actual cash (not as a campaign contribution) in return for a commitment to support legislation authorizing certain pari-mutuel racing.

In Texas, the news is a grand jury investigation of the speaker. The charge is that a major law firm improperly used campaign donations, free vacations, and gifts to influence Speaker Gib Lewis and other legislators in dealing with legislation relating to tax collections. The allegations concern both vacations taken with members of the firm and the firm's payment of a delinquent tax bill owed by a gun emporium partly owned by Lewis. When the subject came up in the November campaign, Lewis repaid the money. In December, the grand jury returned an indictment. The impact on the speaker, who is contesting the charges, is unpredictable. But the incident and Governor Richard's campaign promise to implement stricter reporting requirements for legislators and lobbyists will keep the ethics issue before the legislature this year.

Term Limits: Over 100 supporters of term limits for legislators and/or Members of Congress met in California in December under the aegis of Citizens for Congressional Reform. The Los Angeles County Supervisor who put Proposition 140 on the ballot indicated he was looking toward a measure on the 1992 ballot to limit Congressional terms. Proposition 140 placed a limit of thee two-year terms on California House members and two four-year terms on state senators, as well as mandating a 40% cut in California legislative spending. It was a major victory for term limiters, combining with victories in Colorado and Oklahoma and local elections in Kansas City and San Jose. Some conferees worried that the movement might be weakened by being endorsed by prominent political figures, citing the endorsement by the President.

A hint of the same perspective comes from syndicated columnist Neal Peirce, who in a January column commented, "Anytime you get Dan Quayle, Ralph Nader, the National Taxpayers Union and a bunch of Common Cause chapters on the same side, you know there's a loose cannon on the deck." He suggests that campaign finance reform be the priority, rather than term limits.

Campaign Finance Reform: Campaign finance reform measures passed both Houses of Congress last year, but never emerged from conference committee. There is considerable opposition by well entrenched members. Another attempt will be made this year, which will likely focus attention on the subject in the states as well.

The Outlook: Rich Jones, who works on legislative staffing and procedural issues for NCSL, addresses the future of legislatures in State Legislatures (July 1990). He concludes that the earlier reforms succeeded, citing growth to 33,000 legislative staffers, all but seven states with annual sessions, increased compensation for legislators, and more legislators viewing legislative service as a career and staying in the legislature longer. He gives these changes credit for making possible such actions as complex groundwater legislation in Arizona and other states, education reform in Kentucky and other states, and more.

On "congressionalization," he distinguishes three categories of legislatures. The first -- California, Illinois, Massachusetts, Michigan, New York, Ohio, Pennsylvania, and Wisconsin -- he calls "full-time, professional legislatures." He then defines, without listing, 17 states that have purely part-time legislatures. These relatively small states with limited traditions of government he doesn't view as likely to become full time. This leaves 25 states in between. Notwithstanding attempts to increase legislative efficiency, he feels the challenging workload will win. So.

> When sessions convene in the year 2011 there are likely to be more full-time legislatures than in 1990, and fewer purely part-time bodies. The states in the middle of these two extremes, while not yet full-time, will likely be headed in that direction.

TAX LEVELS

Introduction: A new NCSL report provides approximations of FY 1990 state and local tax burdens for those unwilling to wait for the official Census figures. They won't appear until late this year. The approximations have the disadvantage that the local tax levels, 40% of the total, are assumed not to have changed from FY 1989 to FY 1990.

State And Local Roles As Tax Collectors: The data are a reminder of the difficulties in focusing on state taxes without looking at local ones. The states with the highest state taxes aren't necessarily the states with the highest state and local taxes. Alaska is ranked first. Because Hawaii (#2 in state taxes in relation to personal income) funds its schools entirely out of state taxes and New Mexico (#3) funds them almost entirely this way, they rank much higher than some relatively high tax states, like New York (#24), that rely on local taxes to fund much of education and welfare. The states with the lowest state taxes are well below the 6.8% of personal income taken by the average state. The lowest state tax burdens in FY 1990 were New Jersey (5.7% but with tax increases in FY 1991), Texas (5.4%), Colorado (5.2%), South Dakota (4.9%), and New Hampshire (2.7%).

The report indicates that state taxes accounted for 60.6% of state and local taxes in FY 1989. This percentage varies considerably among the states as shown in Table 1.

Factors Affecting State And Local Roles: There are conflicting forces affecting the relative reliance on state and local taxes. On the one hand, fiscal pressures on states and a desire to avoid tax increases, plus a desire in some states (e.g., Massachusetts and Minnesota) to make local officials bear the consequences of revenue raising will tend to raise the local percentage. The conflict comes with widespread desires to increase the percentage of school costs paid by the state. This is a goal in its own right in some states, a byproduct of desires for funding education reform or finance equalization plans in others. Over the past decades, the state share has been increasing.

Tax Burdens By State: In FY 1990 state and local taxes were 11.37% of personal income. This is only slightly higher than the 11.32% burden in FY 1970. The percentage tends to rise in recessions because

Table 1: Percentage of State/Local Tax Revenue Raised By State, FY 1989

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Delaware	83.5%	18	Nevada	67.3%	34	Michigan	60.2%
2	Hawaii	82.5	19	Maine	66.7	35	Florida	60.1
3	New Mexico	79.7	20	Massachusetts	66.7	36	Maryland	59.7
4	Kentucky	78.0	21	Indiana	66.6	37	Connecticut	59.3
5	West Virginia	77.8	22	Wisconsin	65.3	38	Virginia	59.0
6	Arkansas	75.8	23	Iowa	63.3	39	Ohio	58.5
7	Mississippi	74.5	24	Louisiana	63.2	40	Montana	57.9
8	South Carolina	73.4	25	Tennessee	62.7	41	Kansas	57.8
9	Alabama	71.8	26	Missouri	62.2	42	New Jersey	55.8
10	Washington	71.6	27	Arizona	62.1	43	Illinois	54.0
11	Idaho	71.4	28	Rhode Island	61.1	44	Texas	52.6
12	North Carolina	71.3	29	Utah	60.8	45	Oregon	50.9
13	Oklahoma	69.7	30	Wyoming	60.8	46	South Dakota	49.5
14	North Dakota	68.3		**United States**	**60.6**	47	Colorado	48.9
15	Alaska	68.2	31	Georgia	60.5	48	New York	48.5
16	Minnesota	68.0	32	Pennsylvania	60.5	49	Nebraska	47.7
17	California	67.9	33	Vermont	60.4	50	New Hampshire	34.4

taxes rise while income lags. As a result, the FY 1991 data may show state and local tax burdens to have risen substantially in relation to personal income. The NCSL estimates appear in Table 2.

Table 2: State and Local Taxes As Percent of Personal Income, FY 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Alaska	18.30%	18	Michigan	11.79%	34	Indiana	10.69%
2	New York	15.40	19	North Dakota	11.64	35	Illinois	10.67
3	Wyoming	14.20	20	Nebraska	11.48	36	Kentucky	10.65
4	Hawaii	13.91	21	Idaho	11.41	37	Massachusetts	10.65
5	Minnesota	13.06		**United States**	**11.37**	38	Pennsylvania	10.59
6	Montana	12.68	22	South Carolina	11.32	39	Nevada	10.58
7	Arizona	12.53	23	Rhode Island	11.29	40	Texas	10.50
8	New Mexico	12.47	24	North Carolina	11.24	41	New Jersey	10.50
9	Wisconsin	12.42	25	Maryland	11.13	42	Mississippi	10.41
10	Iowa	12.31	26	Georgia	11.13	43	South Dakota	10.19
11	Oregon	12.30	27	California	11.12	44	Virginia	10.03
12	Utah	12.25	28	Delaware	11.03	45	Florida	10.02
13	Maine	12.19	29	Kansas	11.02	46	Arkansas	9.62
14	Washington	12.19	30	Ohio	10.97	47	Missouri	9.49
15	West Virginia	12.04	31	Connecticut	10.91	48	Alabama	9.41
16	Vermont	11.97	32	Oklahoma	10.81	49	Tennessee	9.40
17	Louisiana	11.81	33	Colorado	10.76	50	New Hampshire	8.22

HEALTH CARE PROBLEMS

Health Policy: The news from the health care front is bad on all counts. At the January NCSL fiscal chairs meeting and at the NGA February meeting, elected officials heard from experts on health care. The messages cited well-known problems such as escalating costs and the large number of persons without health insurance coverage. The speakers had ideas for what states could do as employers to attempt to control costs in their employee plans. Some had policy recommendations for federal action, but there wasn't advocacy of a state level version of universal health care.

The governor's budget in Massachusetts illustrates the impact of fiscal pressures on state activism in health care. The previously enacted universal care plan would be dropped. The state would no longer contribute to the uncompensated care pool. The theory is to cap private contributions with the state bearing the excess cost, but the governor's proposal would eliminate any cap on the contributions from health insurers. Also, the state is seeking to have its employees bear a larger share of their health care costs.

State governments, as major employers, are starting to meet themselves in their other role -- that of concern with access to health care. An example is New Jersey. As in other states, the governor found himself confronted with a tight fiscal situation with sharply escalating costs of state employee health insurance a major cost-increasing factor. Like some other governors, Governor Florio opted to constrain cost by requiring additional employee cost responsibility. From the list of greater co-payments, higher deductibles, reduced service coverage, and greater employee cost sharing in premium costs, he picked the latter, recommending employees pick up 25% of cost. But the tab of $500 for individual coverage and up to $1,200 for family coverage was so large, union officials contended, that it would force some low-paid employees out of health insurance. This would push them into the uncompensated care pool, which was covered by a 19% tax on hospital bills until the legislature failed to renew the program.

Florida and Illinois have programs to provide health insurance for individuals with health problems that would otherwise make them uninsurable. The concept was to limit the rate to about 35% above the regular rate with any excess cost subsidized. Both plans have been popular -- so popular that subsidy costs are being controlled by deviating from the original plan concept. Florida has done this by allowing the price to rise, so the special policies cost twice the regular rate in some cases, more in others. Illinois has maintained the price, but limits participation so it has developed a waiting list.

Bootstrap Financing Of Medicaid: The situation is complex, but the logic is understandable. Start with hospitals losing money on uncompensated services that could be covered by Medicaid but aren't because a state doesn't have enough money to cover the costs. Let the hospitals put up enough money to match the federal funds. The hospitals: (1) get back their contribution and (2) get the federal Medicaid match as a net gain. Versions of this concept have been tried in Tennessee and West Virginia (and other states) and are now under discussion in additional states. A substantial portion of the Pennsylvania budget-balancing plan for the remainder of FY 1991 depends on the concept. A version has also been proposed in Arkansas.

The mechanics are esoteric for two reasons. First, federal law prohibits the transaction if done directly, but there are complex and rapidly changing interpretations that seem to permit it indirectly. Second, the hospitals putting up the money wouldn't necessarily be getting Medicaid reimbursements proportional to their contribution. In their February meeting, the governors adopted several recommendations for federal action on health care. Besides relieving the impact of Medicaid mandates, these included one to let states generate their Medicaid matching money any way they choose. If accepted by federal officials, this recommendation would encourage more states to use "bootstrap financing" for their Medicaid programs.

The math is illustrated by the proposal reportedly agreed to by hospitals and Pennsylvania authorities in January. For one patient with hospital reimbursement of $1,000, the state pays $500 and the federal government $500 (with the federal share higher in states with lower per capita income). Assuming a justifiable cost under Medicaid regulations of $1,100, the hospital would like the extra $100 and the state would like to pay it: (1) to avoid litigation, (2) to be fair to the hospital and other paying patients, and (3) to avoid pressures to pay it in other form such as an uncompensated care pool. So the hospital donates $50 to the state, which secures the $50 federal match, and pays it to the hospital. The hospital gains $50 with no loser other than the federal government. The complexity of the proposals is illustrated by the fact that Pennsylvania announced that $350 million would be gained by its agreement with the hospitals, but a hospital association spokesperson suggested the number would be closer to $200 million.

Bootstrap Financing For The Uninsured: Health care policymaking and state resource allocation are proceeding on largely separate tracks. Blue ribbon groups continue to study major health plans for the uninsured involving new taxes and new general fund spending. At the same time, elected officials and their budget staffs are considering cutbacks in existing programs in an attempt to avoid or minimize new taxes. As State Health Notes (January) summarized its survey of the states, "The irony is that even as states are grappling with major budget shortfalls that may involve deep cuts in Medicaid, many are continuing to explore strategies that would enable them to expand coverage to the uninsured."

Nursing Home Regulations: The Medicaid mandates aren't the only factor driving up the costs of state Medicaid programs. Federal 1987 nursing home reform legislation increased nursing home costs substantially by such requirements as a full time social worker for every 120 beds and increased training for nurses aides. California has been resisting accepting the requirements, claiming the state's are substantially identical. The federal government has threatened a cutoff of Medicaid funds for the state. The state has also lost a case on the subject in a federal district court.

Provider Reimbursement Litigation: Illinois hospitals figured they would have difficulty in getting more money, "unless we have a court putting a gun at the head of state government." So they sued, timing the action the week before the November election so it wouldn't appear to be aimed at one gubernatorial candidate or the other. Both pledged not to raise taxes and one wanted to roll back a tax that already exists. The IHA is following the successful pattern of the Virginia association with litigation also occurring with hospitals elsewhere such as Colorado, Michigan, and Pennsylvania and with nursing homes.

The decision created an "immediate budget crisis" according to Kansas' new governor. A federal court invalidated the freeze on nursing home rates, forcing the state to go back to October to adjust reimbursements as well as to adjust future ones. The governor is trying to sell a major tax increase on the grounds that it will provide needed property tax relief, but some of the money will be needed to finance Medicaid and other state operations.

FINANCING THE SCHOOLS

Education Tax Increases: The concept of raising state taxes in the name of education quality improvement has lots going for it, at least in the Southern states. Kentucky and Oklahoma passed education improvement measures last year, along with whopping state tax increases in both states.

This year, Arkansas became the first state to increase taxes when a half-cent increase in the sales tax was approved by over 80% margins in both houses. The measure, along with applying the tax to used cars, which also passed, was proposed by Governor Clinton after his decisive victory in November over an anti-tax opponent who campaigned against Clinton's persistent habit of seeking higher taxes for education. The money will go into an education excellence trust fund where it will support spending from pre-school to universities.

Business leadership was an important element in Arkansas, Kentucky, and Oklahoma and could be an element in the proposal that is expected in Tennessee. In Missouri, where the governor hasn't endorsed a tax increase, Associated Industries of Missouri and the Missouri Chamber of Commerce are campaigning for a 10% increase in personal and business income tax liabilities to finance education improvements.

School Finance Litigation, Texas: The Texas supreme court has ruled that the new school aid formula violates the state constitution by discriminating against districts with a low tax base per pupil. The court set an April deadline for a new plan. This recreates last year's situation in the legislature. Fearing a showdown with the judiciary, which arguably would have rewritten the formula itself, the legislature decided to act, after a number of special sessions. Its solution was a significant increase in school aid, with emphasis on the poorer districts but not enough emphasis to create full equalization. The solution required a sales tax increase and included sharp future increases in school aid. Funding those increases represented a major pressure for a tax increase even before the recent court decision.

Equalization Litigation And "Rich" Districts: School districts with above average tax base per pupil are showing increasing interest in equalization litigation, basing their claims on the ground that their high concentration of at risk, difficult-to-educate pupils requires a greater share of state aid than they now get. Examples: Newark and other New Jersey communities, Cleveland, and New York City. Albuquerque has a special density factor to respond to such concerns, but it hasn't been funded and won't likely be in the tight budget this year. So those interested in the city's schools are supporting legislation permitting a local option tax.

MISCELLANY

Bond Ratings: Fiscal pressures are likely to take a toll in bond ratings. Nine states have AAA bond ratings from S&P: California, Maine, Maryland, Missouri, New Jersey, North Carolina, South Carolina, Utah, and Virginia. Several of these would appear likely downgrades unless they take aggressive action to balance their budgets on a sustainable basis. S&P recently put California and Maine on CreditWatch.

California's budget is balanced on many assumptions including: (1) legislative approval of many controversial elements, (2) accepting the notion that revenue should be counted when taxpayers owe it rather than when they pay it, and (3) accepting a billion in revenue based on the explicit assumption that the state's economy will improve faster than forecasters say it will. Maine's budget has similar problems, plus a large savings associated with not making scheduled payments to the state's retirement fund. Both states are increasing their operating borrowing. Virginia is balancing its budget in part by more borrowing for capital costs than in the past, but has done comparatively little in the past.

Economic Development: In an analysis relating state fiscal outlooks and municipal bond prospects, Goldman Sachs used employment growth to examine the relative performance of states. It compared the growth of employment in the 1982-87 period to more recent annual growth rates in the 1988-1990 period. The result is expressed as a change in growth rates. For example, U.S. employment growth in the earlier period was a 2.64% annual increase. In the later period it was 2.54%, giving a change of -0.10%. Changes for states appear in Table 3.

Table 3: Change In Annual Employment Growth Rate, 1982-87 and 1988-90

Rank	State	Change	Rank	State	Change	Rank	State	Change
1	Wyoming	5.57%	18	Mississippi	0.66%	34	Missouri	-0.85%
2	Oklahoma	3.47	19	Kentucky	0.56	35	Florida	-1.12
3	Idaho	3.29	20	South Dakota	0.52	36	New York	-1.23
4	Nevada	2.67	21	Colorado	0.46	37	North Carolina	-1.37
5	Alaska	2.66	22	Illinois	0.40	38	Delaware	-1.59
6	Louisiana	2.52	23	Wisconsin	0.39	39	Maine	-1.59
7	Montana	2.39	24	Indiana	0.26	40	Virginia	-1.62
8	Iowa	1.93	25	Ohio	0.08	41	Maryland	-1.66
9	West Virginia	1.59	26	New Mexico	0.05	42	New Jersey	-1.7
10	North Dakota	1.31	27	Minnesota	0	43	Michigan	-1.8
11	Oregon	1.29	28	Pennsylvania	-0.04	44	Georgia	-2.11
12	Washington	1.27		**United States**	**-0.10**	45	Vermont	-2.17
13	Texas	1.19	29	Arkansas	-0.10	46	Connecticut	-2.28
14	Utah	1.13	30	South Carolina	-0.17	47	Rhode Island	-2.72
15	Hawaii	1.08	31	California	-0.57	48	Massachusetts	-3.13
16	Kansas	0.86	32	Tennessee	-0.75	49	Arizona	-3.43
17	Nebraska	0.78	33	Alabama	-0.85	50	New Hampshire	-5.42

This table reflects the change in trends in state economies. The losers are concentrated on the East and West coasts. They include California, Arizona, and Missouri, but no other state West of the Mississippi. There is an extremely close correlation between states below the national average on Table 3 and states experiencing major difficulties in balancing their budgets without raising taxes.

The Federal Budget: The President's budget for FY 1992 contains no funding surprises, as the level of funding for programs of interest to states was basically set by the budget agreement late last year. The budget reflects a long-term but slow phasedown of the defense budget. Excluding the Gulf War, it rises less than the rate of inflation -- remaining large enough so there really wouldn't be a "peace dividend."

In the State of the Union message, the President proposed to consolidate about $15 billion of federal programs into block grants to the states. This proposal is new, but similar proposals have been made since the Nixon Administration. The proposal is the starting point for negotiations with state officials, not the result of earlier negotiations. Getting agreement between the Administration and state officials won't be easy. At the state level there is distrust of such proposals as screens for budget cutting and concerns that block grants, once enacted, become vehicles for mandates and restrictive provisions that restore the substance of the categorical programs supposedly replaced. In addition, with no new money in the pot, there are delicate problems in distributing money among states.

Even if a plan is produced that is acceptable to the Administration and states, Congress is a substantial hurdle. Block grants cut into the power base of Washington-based national advocacy organizations built around categorical programs and affect the perceived importance of some Congressional subcommittees. Initial indications suggest that representatives of city governments will oppose the block grants. They would incorporate the current community development block grants -- a direct federal-local program -- as well as certain housing, law enforcement, and other grants where some local officials might feel threatened that assistance would be diverted away from them. The United States Conference of Mayors announced opposition in early February.

In their February meeting, the governors did not seek additional federal general fund money. They urged spending of money from existing trust funds -- airports, highways, transit, and Unemployment Compensation -- and a moratorium on mandated increases in Medicaid spending. Adoption of the moratorium would save federal as well as state dollars, though the NGA policy does discuss federal assumption of full responsibility for Medicare-eligible persons who now receive some Medicaid support.

Governor Chiles (I-FL) spoke to the National Press Club in February with a message reflecting widespread disillusionment among governors with solutions from Washington: "The federal government should steer, not row. The Washington delivery system just doesn't work. I just want Washington to leave me alone."

Litigation: Budget-busting litigation is occurring practically everywhere. School finance equalization litigation is underway in many states and threatened in others. Responding to a state supreme court decision could produce higher taxes in Texas, while anticipating one is one factor encouraging a Tennessee tax increase. Medicaid provider reimbursement has been settled at considerable state expense in Michigan and is pending in many states including California and Illinois. Tax discrimination against interstate commerce led to revision of Arkansas taxes on used cars and, before the session is over, will likely lead to a higher gas tax and other transportation revenue measures to replace revenue from an invalidated flat tax on truckers and to pay the millions owed truckers in a settlement. Many states are still at risk for retroactive liability for refunds for federal retirees. Many corrections institutions are operating under consent decrees, a few under contested court orders, and many more in hopes of avoiding such a situation. To a somewhat lesser degree, this affects mental health and mentally retarded/developmentally disabled, with New Mexico a major example.

In Illinois, a federal court may be reaching the point of an order affecting the overall activities of the Department of Children and Family Services. The tab will be in the broad range of $10-60 million. In New York, the issue is the shelter allowance for welfare recipients.

Pension Plans: While a few states have responded to fiscal problems by reducing their contributions to retirement plans, the impact nationwide has been overwhelmed by states continuing regular contributions and high returns on pension investments in fixed income securities. The latest compilation by the Census Bureau showed major state-administered plans with assets of about $600 billion at the beginning of FY 1991. The total was up 10.6% from a year earlier. During the final quarter of FY 1990, employer contributions covered amounts paid to employees, leaving $3.1 billion in employee contributions and $13.1 billion in investment earnings to add to assets.

Tax Choices: At the January NCSL fiscal chairs meeting, there was a general discussion of tax options, with no particular consensus. Extension of the sales tax to services and the general subject of tax exemptions-tax expenditures drew considerable discussion. There was also consideration of how to make the tax system more progressive. A good summary of the prospects for federal tax simplification appears in the National Journal (1/5). Lawrence Haas concludes in "No Simple Matter" that not much change is likely anytime soon.

"Temporary" Taxes: So many tax levies are labeled "temporary" that experts and citizens alike are skeptical about the whole concept. "Temporary levies" generally become permanent, but a few do expire. A special North Dakota levy for economic development was allowed to expire in the mid-1980s. A Missouri tax to fund refunds to retirees under the Davis case is expiring on schedule. And the California quarter cent levy for earthquake relief has expired. To keep their record of session that didn't raise taxes intact, Iowa legislators let the cigarette tax rate drop by several cents in the late 1980s. But these are exceptions. Most share a common feature -- the revenue was earmarked for something specific that wasn't an ongoing cost.

In the last recession (1982-83), 17 states raised their income taxes, many on a temporary basis. In recovery during 1984 and 1985, fiscal expert Steven Gold estimates that 12 of those states rolled back at least a part of their increases. This possibility hasn't received much consideration by states in the current situation. Three possible reasons: (1) fear that the deficits are structural and thus not amenable to temporary solutions, (2) concern that the recession reflects a long-term slowing of economic growth, and/or (3) tax opponents, who might accept temporary taxes as a last resort, haven't been pushed to the last resort yet. One exception: the proposed tax increases in Vermont.

Tribal Relations: The Midwestern Legislative Conference of the Council of State Governments (641 E. Butterfield Rd., Lombard, IL 60148) recently published an assessment of issues between states and Indian tribes, Midwestern State-Tribal Relations: The Search For Common Ground.

TECHNICAL NOTES

Cost Cutting: The assessment of state finances from a higher education perspective by the American Association of State Colleges and Universities (One Dupont Circle, Washington, DC 20036) appears in Report Of The States: 1991 Annual Budget And Fiscal Survey.

Cuts Affecting Local Government: The Thomas quote is from ACIR's Intergovernmental Perspective (Winter 1991). The entire issue is devoted to county government. Most of the important impact of state cuts is on governments best considered counties, even though counted as something else (e.g., municipalities, townships) in Census statistics. Many major cities (e.g., Baltimore, Boston, New York, Richmond, and San Francisco) have functions identical to counties in their states, which don't have the phenomenon of counties containing municipalities (e.g., Virginia) or don't follow the pattern for certain major cities (e.g., New York). The organization of states like Massachusetts and Connecticut is essentially identical to Virginia --- some large independent cities and other areas governed by a single level of government with no level beneath it. The non-cities are called counties in Virginia and towns in New England, but the administrative and fiscal relationships with the state are the same.

The U.S. Advisory Commission on Intergovernmental Relations (Washington, D.C. 20575) recently published an inventory of local ACIRs, Directory of State-Local Relations Organizations: The ACIR Counterparts. The South Carolina ACIR (P.O. Box 12395, 1333 Main St., Columbia, SC 29211) is an example of how these organizations work. In its recent report, South Carolina Local Government Capital Project & Infrastructure Needs Survey, the group inventoried local capital outlay needs. It has offered recommendations for dealing with these needs without state outlay by state authorization of project-specific local option sales taxes and relaxing certain debt limits on local government. In Aid To Subdivisions: An Examination Of State Shared Revenue In South Carolina, it recommended the simplification of local aid programs by providing local governments with a payment that would grow in proportion to the state's general fund, explicitly recognizing that the plan would force local governments to share proportionately (but not disproportionately) in revenue shortfalls affecting state government.

The Indiana Fiscal Policy Institute (251 N. Illinois St., Indianapolis, IN 46204) assessment appears in its Fiscal Policy Bulletin (September 1990).

Legislative Reform: Executive-legislative relations are somewhat different in many Southern states than in the rest of the nation. Some of those states have weaker executive budget traditions and less gubernatorial control over appointments, but more tradition of having the governor involved in the selection of legislative leaders. North Carolina, the only state where the governor doesn't have a veto, is an interesting case study. See North Carolina Insight (12/90, NC Center for Public Policy Research, P.O. Box 430, Raleigh, NC 27602). In South Carolina, the governor used the indictment of legislators as a basis for a call for more accountability in the executive branch with more single accountable heads of state agencies and less government by board and commission, a change to what is known locally as "cabinet government."

The "wrong track" question comes from the WSJ-NBC poll reported in the Wall Street Journal (10/26). The Media General-Associated Press poll was carried on AP wires shortly after being taken in Sept. 14-24. The California Poll appeared in the Sacramento Bee (9/12). The Michigan one in Public Opinion Monitor (11/1, Public Sector Consultants, 300 S. Washington Square, Lansing, MI 48933). The Arizona Poll was reported in the Arizona Republic (9/9).

Many related ethics issues in state government are the theme of State Government News (4/90). The issue includes a debate on disclosing income tax returns and a comprehensive story on the issue of accepting gifts and trips from lobbyists. The Texas House Research Organization (P.O. Box 2910, Austin, TX 78769) has an extensive new report, Campaign Finance, that discusses practices of the states and the federal government and discusses reform options.

Economic Development: The Goldman Sachs analysis appears in the firm's Monthly Market Perspective for January.

Tax Levels: The Census Bureau has completed its data collection on both state and local finances for FY 1989. The state results are published as State Government Finances In 1989 (August 1990), complete with computations of per capita amounts and comparisons with personal income. The local results appear separately and in combination with state results in Government Finances: 1988-89, Preliminary Report (September 1990), without the per capita and personal income calculations. Those were calculated by **Reports** last fall. A final Census version will eventually appear.

The Census Bureau hasn't yet published comparative data on state or local taxes for FY 1990. The NCSL report, Recent Changes in State, Local, and State-Local Tax Levels, fills this void for states by using the Census data published in Quarterly Summary of Federal, State, and Local Tax Revenue. The report uses FY 1989 data for FY 1990 for local taxes. This assumption of constant local tax burdens is likely to be wrong, as preliminary data indicate a property tax increase of 12.9% in FY 1990, while personal income rose only 7.6%. The growth of local taxes relative to personal income is likely to appear in some states but not others.

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March 1991 (First of Two March Issues)

LETTING THE STUDENTS PAY

Introduction: The state budget pressures are affecting higher education in ways that may produce major changes in student opportunities and the roles of public institutions.

The Budget Problem Grows: Compilations by the National Conference of State Legislatures (NCSL), State Budget & Tax News, and the National Governors' Association (NGA) show about 30 states are experiencing shortfalls in their current (FY 1991) general fund budgets. Because this list includes nearly all of the largest states and excludes primarily smaller Western states, about 80% of U.S. population lives in states with shortfalls. States with imbalance in their new (FY 1992) budgets are harder to count because of differing definitions of baseline budgets. The number is somewhere near the 34 recently counted by State Budget & Tax News. Many states have been revising their revenue estimates downward in the last month, making the current situation worse than indicated by any of these surveys.

Higher Education As A Target For Cuts: "Not since the early 1980s has higher education been in such dire financial straits," according to the Chronicle Of Higher Education (2/27). With isolated exceptions, higher education hasn't been singled out as a target for budget cutting. Budget cutters aren't saying more money is unnecessary, just that they can't afford to provide it. While not necessarily a per se target for cuts, higher education is frequently reached by the process of elimination. So, its cuts are often disproportionate to those for other categories of state spending.

Increases in welfare are linked to increasing caseloads and to polices in most states not to cut payment levels to welfare families. Medicaid increases of 15% or more in many states are driven by the welfare caseload, federal mandates, and increasing health costs. Corrections costs are being driven by prisoner count increases. Elementary and secondary education is being protected economically by property taxpayers, who might have to pay if the state doesn't, strong teacher organizations, and substantial commitments by state elected officials. Thinking along these lines has concentrated the cuts in FY 1991 and especially FY 1992 on functions such as local aid other than schools, state operations, and higher education.

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Cuts in higher education also tend to be attractive, at least relative to other cut options, because they offer the best of both worlds. They appeal to those who believe spending is too high in universities. But they also can appeal to those who don't favor cuts, but believe tuition can be raised to combine reasonable spending levels with stable or even declining state appropriations.

State Higher Education Appropriations: The states have developed quite divergent levels of support as indicated by the appropriations per student (excluding capital outlays) shown in Table 1.

Table 1: Higher Education Appropriations Per Student, FY 1990

Rank	State	Amount	Pct. Av.	Rank	State	Amount	Pct. Av.
1	Alaska	$10,084	230%	26	Oregon	$4,105	94%
2	Hawaii	8,092	184	27	Illinois	4,099	93
3	New York	6,108	139	28	Virginia	4,089	93
4	Connecticut	6,071	138	29	Michigan	4,086	93
5	New Jersey	5,944	135	30	Arizona	4,085	93
6	Wyoming	5,942	135	31	Oklahoma	4,074	93
7	Florida	5,673	129	32	Indiana	4,044	92
8	Maine	5,311	121	33	South Carolina	4,038	92
9	Massachusetts	5,142	117	34	Kansas	3,954	90
10	California	5,099	116	35	Missouri	3,661	83
11	Washington	4,697	107	36	Nebraska	3,586	82
12	New Mexico	4,695	107	37	Ohio	3,577	82
13	Nevada	4,601	105	38	Kentucky	3,552	81
14	Delaware	4,594	105	39	Montana	3,542	81
15	Minnesota	4,571	104	40	Arkansas	3,486	79
16	Idaho	4,518	103	41	Alabama	3,467	79
17	Maryland	4,476	102	42	South Dakota	3,348	76
18	Rhode Island	4,475	102	43	Texas	3,341	76
19	Iowa	4,445	101	44	North Dakota	3,137	72
20	Georgia	4,442	101	45	Mississippi	3,018	68
21	Wisconsin	4,411	101	46	Colorado	2,927	67
	United States	**4,388**	**100**	47	Louisiana	2,854	65
22	North Carolina	4,318	98	48	New Hampshire	2,677	61
23	Utah	4,293	98	49	West Virginia	2,592	59
24	Tennessee	4,150	95	50	Vermont	2,421	55
25	Pennsylvania	4,147	95				

Spending well above average is found in Alaska, Hawaii, and Wyoming -- consistent with their extraordinarily good fiscal positions. The other states that exceed the national average by 10% or more enjoyed more than average prosperity in the late 1980s, but now have some of the worst fiscal problems in the nation -- California, Connecticut, Florida, Maine, Massachusetts, New Jersey, and New York. The battle over higher education funding is likely to be most heated in those states. Because of their fiscal circumstances, the outcome may be least satisfactory for higher education interests.

State And Student Funding: A recent NCSL survey of legislative leaders (Leaders' Outlook: 1991) suggested:

> The pattern for higher education funding has been to decrease the state share and increase the institutional share. Where this trend continues, the relationship between the universities and the legislature undoubtedly will be tense.

The percentage of operating costs defrayed by tuition is shown in Table 2.

Table 2: Percentage Of Operating Cost Paid By Tuition, FY 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	7.9%	18	Montana	23.0%	34	Wisconsin	30.4%
2	California	8.5	19	Connecticut	23.2	35	Mississippi	30.8
3	Wyoming	11.9	20	New Jersey	23.2	36	Virginia	31.2
4	Alaska	12.4	21	Oklahoma	23.5	37	Iowa	31.3
5	Idaho	13.2	22	Massachusetts	24.0	38	Indiana	32.1
6	New Mexico	14.8		**United States**	**24.1**	39	South Dakota	32.2
7	North Carolina	15.3	23	Nebraska	24.8	40	Rhode Island	32.7
8	New York	16.9	24	Kansas	25.6	41	North Dakota	34.7
9	Florida	17.4	25	Maine	25.7	42	West Virginia	34.7
10	Washington	19.5	26	Tennessee	25.7	43	Ohio	37.7
11	Nevada	20.0	27	Oregon	25.8	44	Michigan	38.7
12	Illinois	20.2	28	Kentucky	26.7	45	Louisiana	39.3
13	Arizona	21.4	29	South Carolina	27.8	46	Pennsylvania	39.6
14	Georgia	21.8	30	Arkansas	28.2	47	Colorado	42.1
15	Texas	21.8	31	Missouri	29.2	48	Delaware	47.0
16	Utah	22.6	32	Alabama	29.5	49	New Hampshire	53.3
17	Minnesota	22.9	33	Maryland	29.7	50	Vermont	70.6

The standard range of state policy is for students to pay 20-40% of higher education costs. Only four smaller states -- Colorado, Delaware, New Hampshire, and Vermont -- exceed this level. Eight states are below it in the range of 10-20% while Hawaii and California were below 10% in FY 1990. Big changes are taking place in California (8.5%) and New York (16.9%) that will lift their percentages substantially and, because of their size, also lift the national average substantially. As a result of the state fiscal problems, FY 1991 and FY 1992 tuition changes are likely to exceed both: (1) inflation and (2) the increase in state appropriations per student.

In Missouri, for example, the Board of Curators had already approved a 6% increase in tuition, but didn't anticipate the governor's budget. To avoid a tax increase in the face of poor revenue performance, it recommended a slight cut in higher education appropriations. The University of Missouri president suggested shifting to a 12% tuition increase to adjust to the expected budget. To avoid a major tax increase, Florida's governor is seeking fee increases of 20% for in-state students and 25% for out-of-state students.

Scholarships: One of the rationales of having state-sponsored universities is affordability, which is probably the argument most citizens would think of if asked to explain why state government should be in the university business. As a result, many legislators have difficulty in accepting the concept of high tuition at state institutions. The acceptance is particularly low when considering New England vocational-technical schools, which are historically extensions of the public schools as grades 13 and 14, community colleges, and in dealing with low income students. This concern explains the recent popularity of guaranteeing to certain "at risk" elementary students the chance to go to college if they do well through high school.

Scholarships are partially an antidote to higher tuition and fees at universities, preserving access for those who qualify on the basis of need. As a result, it is customary for proposals for higher tuition to be accompanied by the assurance that access won't be limited because an offsetting expansion of scholarship assistance will take place.

Scholarships come in three forms. The first are those generated outside of state government, such as foundations, trusts, and the federal government. The second is scholarship money from individual schools. The third, which is of most immediate interest in considering offsets to tuition, is state-administered scholarship programs. A total of $2.15 billion is being provided by these programs this academic year. The largest programs are in New York ($439 million), Illinois ($203 million), California ($165 million), Pennsylvania ($146 million), Texas ($118 million), New Jersey ($102 million), Ohio ($80 million), Minnesota ($78 million), Michigan ($75 million), Massachusetts ($72 million), and Florida ($69 million). The data show differences in state funding policies clearly when put on a per capita basis as done in Table 3.

New York tops the list in scholarship assistance (Table 3), notwithstanding its low reliance on tuition (Table 2), and its high per-student appropriations (Table 1) -- all statistics combining to show one major reason why the state's spending and taxes are well above comparable states. The two states most reliant on tuition (Table 2) have sharply different approaches to scholarships. Vermont (2nd on Table 3) provides the second highest level in the nation, while New Hampshire retains its low tax state policy by both high tuition and low scholarships.

Table 3: Per Capita State Scholarship Aid, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	New York	$24.3	17	Ohio	$7.4	34	Tennessee	$3.7
2	Vermont	19.8	18	Colorado	7.3	35	Georgia	3.5
3	Minnesota	17.7	19	West Virginia	7.2	36	Delaware	2.8
4	Illinois	17.7	20	Texas	6.9	37	Kansas	2.7
5	Iowa	14.4	21	Utah	6.6	38	North Dakota	2.3
6	New Jersey	13.2	22	South Carolina	5.5	39	Arkansas	2.2
7	Pennsylvania	12.2	23	California	5.5	40	Nebraska	1.4
8	Massachusetts	11.9	24	Florida	5.3	41	New Hampshire	1.3
9	Oklahoma	11.1	25	Kentucky	5.2	42	Louisiana	1.2
10	Connecticut	11.0	26	Alaska	4.7	43	Arizona	0.9
11	Rhode Island	10.6	27	Washington	4.5	44	South Dakota	0.8
12	Wisconsin	9.1	28	Maryland	4.4	45	Idaho	0.7
13	New Mexico	8.8	29	Missouri	4.2	46	Mississippi	0.7
14	North Carolina	8.8	30	Maine	4.1	47	Hawaii	0.5
	United States	**8.6**	31	Oregon	4.1	48	Wyoming	0.5
15	Indiana	8.5	32	Virginia	4.1	49	Montana	0.5
16	Michigan	8.0	33	Alabama	3.9	50	Nevada	0.3

Non-Need Scholarships: If the state's role is viewed as assuring a college opportunity for a particular student, a strong argument can be made that the state can buy that opportunity as well as make it by providing universities. Responding to this argument, some states provide scholarships to residents who wish to attend private colleges and universities. This looks like a voucher plan for elementary and secondary education, so the policy has opponents among those who want to conserve scarce state funds for public institutions and those who oppose what they see as aid to institutions some of which are affiliated with religion. There are also non-needs scholarships, such as those designed to entice outstanding graduates of a state's high schools to attend its universities. Some states have no program of either type. Others have quite small programs. Table 4 shows those states with non-need scholarship programs of $1 million or more for undergraduates in FY 1991.

Table 4: State Non-Need Scholarships ($ million), FY 1991

State	Amount	State	Amount	State	Amount
Florida	$40.5	Virginia	$16.9	New Jersey	$5.8
Ohio	26.8	Georgia	16.3	Maryland	5.0
North Carolina	24.6	Missouri	10.1	New Mexico	4.0
New York	24.2	Colorado	9.8	Oklahoma	2.9
Illinois	18.3	Alabama	6.5		

The Fate Of Scholarship Programs: While there is sentiment for scholarship programs to rise consistent with tuition increases, this outcome isn't guaranteed in any state's budget process. One of the more interesting debates will likely occur in Massachusetts, where the governor has recommended that current scholarship programs be converted to loans. He is also suggesting that public university tuition rates be set on a graduated basis, varying with student financial capacity.

University Response to Budget Reductions: The pattern in many states has been for the flagship institution(s) to respond to apparently inevitable budget reductions by measures that permit maintenance of faculty salaries, research programs, and other indicators accepted by academics as signs of excellence. The key to this is reducing enrollment, which translates into making it harder for the state's high school graduates to attend the flagship(s). This phenomenon has been particularly noticeable in the Midwest, with Kansas and Minnesota examples.

The concept is likely to hit California this year. California has three tiers of higher education: (1) community colleges, (2) the California State University system, and (3) the University of California system. Facing a shortfall estimated at $7-10 billion, the governor's budget provides UC nearly $300 million less than its definition of needs. The governor suggested a 20% increase in student fees, but UC officials are talking about a 40% increase, on top of 10% this year. The result, $2,500 a year, would leave UC a low-tuition university system by national standards, but with outrageous tuition by historical standards of a state which broke its no tuition policy recently and still prefers the word "fees" to "tuition" as a way of describing what students must pay to attend.

According to the chairman of the UC Board of Regents the "tragic budget" will have another effect:

> We will not cut back on quality. We will cut back on quantity if we have to but not on quality. It is my position that if we have to cut back in faculty, we will cut back in students. We would rather have a reduction in quantity, not quality.

This effect would be achieved by making it harder to get in. Students would need better credentials as indicated by grade point averages and Scholastic Aptitude Test scores.

TAX POLICY AND BUSINESS CLIMATE

Introduction: The simplistic view of economic development and business taxes is that a state should *tax business as little as possible* in order to provide an attractive business climate. A broader, but also simple, view is that states attract businesses by *keeping all taxes, not particularly business taxes, low.* By the second theory, Florida, Nevada, and New Hampshire have lots going for them. All have low tax burdens and spending levels. None of the three has a personal income tax. Nevada has no corporate income tax. New Hampshire has no sales tax.

But when additional state money is needed, the absence of broad-based taxes on individuals like a personal income tax draws attention to raising property taxes, with heavy impact on business, and business taxes. This year, all three states have major debates over tax policy. They are considering ways to tax business, like versions of value added taxes, that could draw attention in other states. In all three states, there is considerable support for higher taxes from the business community itself, though the support isn't necessarily for the most popular tax options.

Fiscal Circumstances: The three states have experienced extraordinary economic growth in the 1980s. Florida and Nevada have become popular as retirement communities and have profited from in-migration among the increasing ranks of the affluent elderly. In Nevada, the gaming industry has done well, encouraging additional Las Vegas hotel construction that itself has created many jobs and put the city on the map as a convention destination. Florida's tourism remains popular. New Hampshire has been drawing population oriented toward the metropolitan Boston area. All three states have had considerable success, from a low base, in attracting high tech manufacturing.

But economic growth has its costs in increasing demand for public services. This is particularly apparent in the demand for new infrastructure, but also appears in expanding school enrollments. The revenue structures of the three states are slow in reaping the benefits of growth. Nevada's growth has made the gaming industry, the source of much of the state's revenue, a smaller proportion of total economic activity. Expansion of state-funded social services puts New Hampshire in a sharply expanding spending mode while traditional revenue sources, like excise taxes, aren't rapidly growing. Florida relies heavily on sales taxes that haven't been growing as rapidly as spending. The problem was recognized some years ago by an expansion of the sales tax to services, but when opposition appeared the governor and legislature repealed the extension and raised the tax rate.

Florida has a shortfall in the current service budget for FY 1992. Before and after election, Governor Chiles indicated an interest in "tax reform," but said the legislature should obtain public confidence in government before raising taxes. New Hampshire has suffered economic reversals worse than just about any other state in the U.S., giving it major budget shortfalls. Nevada doesn't have a shortfall, but is likely to experience one as soon as its nation-beating rate of economic growth slows, as it must.

Recommendations For Florida: Florida's Chamber of Commerce recently released an extensive report on tax structure that skirts endorsement of higher taxes. The report suggests, "A good business climate now is about more than simply low taxes." The report places heavy emphasis on public spending on infrastructure, education, and helping business start-ups. It discusses tax principles on a revenue-neutral basis. However, in the Florida environment, the recommendations will be considered as ways of increasing total state taxes. Indeed, one of the indictments of the current system is a "growing awareness that Florida's fiscal foundation is inadequate for supporting state needs and fostering a stable business environment."

The report offers five options for reform. The first would expand the sales tax to goods currently exempt, but exempt business purchases of machinery and equipment. Property taxes would be reformed by assessment at full value and elimination of homestead exemptions. The second option would extend the sales tax to services excepting intermediate services provided to businesses whose final products will themselves be taxed. The third option is a single business (value added) tax to replace the corporate income tax and certain other business taxes. The fourth option is a personal income tax, now prohibited by Florida's constitution, with revenues tied to people investments by a "Human Investment Trust Fund." The fifth, presumably best, alternative combines the single business tax, the broadened sales and property taxes, and a personal income tax.

The 140+ page report gets to its conclusions laboriously and obscurely, presumably because the Florida Chamber wasn't comfortable with advocating them clearly. In simple terms, the report reflects some conclusions widely endorsed by tax experts and widely reflected in tax policies of other states including taxing personal income and avoiding massive erosion of the property tax base by homestead exemptions. Adopting these policies is clearly more of a challenge than Florida's governor wants to accept this legislative session.

Payroll Taxes In Nevada: There is a comparable issue in Nevada. The state's major teacher organization put a measure on the November ballot to adopt a corporate income tax. Many corporate and economic development leaders were opposed, along with the governor. But it wasn't clear that the measure would be defeated. The result was general agreement that the legislature would pass some sort of business tax in the 1991 session. The legislature is now considering alternatives comparable to those being discussed in New Hampshire. The base would be broad (e.g., total payroll) and the rate would be low (e.g., 1%).

Income Taxes In New Hampshire: New Hampshire officials have gotten into some exotic tax alternatives in an effort to raise money while relying heavily on a corporate income tax and avoiding a wage tax. The corporate profits tax inherently doesn't raise money from unprofitable corporations, a category including large corporations that don't happen to make a profit in a particular year and smaller ones that don't make profits because they use up all potential profits as compensation for owners. The incentive to do this in the Granite State is very high as the profits are taxed but wages aren't. {Most states and the federal government set top bracket individual and corporate rates near the same percentage.} The latest New Hampshire proposal is a uniform business tax. The base would be: (1) profits, (2) wages and salaries, (3) depreciation, and (4) certain other items. It resembles a value added tax.

Common Problems Of The Three States: All these states have a comparable problem. Their tax policies inherently bear more heavily on business than the policies of other states. The lack of a personal income tax in all of them, a narrow sales tax base (and no tax in New Hampshire), and the narrow property tax base in Florida all lead to high reliance on business taxes. The net burden on particular businesses isn't necessarily greater in these three states than others because state and local spending is lower. But with the current configuration of their tax systems, these states find it hard to raise added money for education or budget balancing without further increasing business burdens or considering major new personal taxes -- a personal income tax, a broadened base of the sales tax on consumer services, and higher property taxes on individuals. Avoiding these major taxes on households draws attention to ways to get more money from business. As a result, there is considerable interest in all three states in taxes closely resembling value added taxes, although state officials are avoiding the term "value added tax."

Another state that arguably has this problem is Texas. There the alternative to taxes affecting individuals -- broadening the base of the sales tax, a statewide property tax, or an income tax -- is expanding the base of the corporate franchise tax.

Taxing Value Added: On February 19, the U.S. Supreme Court decided a case (Trinova Corp. v. Michigan Department of Treasury) that some had expected might undermine Michigan's value added (single business) tax. Six justices sided with Michigan, two dissented, and recently appointed Justice Souter didn't take part in the case. The issue was how tax liability of multi-state corporations is divided among states. The court had long ago affirmed that the traditional three factor formula was fine for corporate income taxes. It attributes income in accordance with a state's share of a corporation's sales, property, and payroll. But the value added tax has a different base -- including interest, depreciation, and labor costs as well as income (profits). Trinova is an auto component supplier with only minor operations, but 26% of its sales, in Michigan. It claimed that the resulting substantial apportionment of tax liability to Michigan was unfair and violated the interstate commerce clause of the U.S. Constitution.

It is impossible to determine the extent to which constitutional concerns have been a barrier to value added taxes in states outside Michigan. However much it was such a barrier, that barrier has been eliminated. Value added taxes are probably also getting a boost from the poor performance of corporate profits, and thus corporate profits taxes, over the last several years. Interest has developed in value added, under other names, in Nevada and New Hampshire. This adds to past interest that has appeared in tax studies in states such as Texas and Louisiana. These factors suggest that value added taxes will be an increasingly serious state tax option.

A key factor in acceptance of the concept is likely to be the attitude of business itself. Some businesses, particularly manufacturing and utilities, could gain from a revenue-neutral shift to value added business taxes. To date, they have shown little interest in supporting such a shift. Many state officials would be reluctant to push a shift over united business opposition. Even in the midst of recession and fiscal problems, many state officials are reluctant to add taxes on business. Connecticut and Massachusetts provide examples among states that have traditionally had the most "liberal" policies, by just about any definition of liberal. As always, there are exceptions -- with the Pennsylvania governor's proposal to raise the profits tax {though to a level below where it once was} an example.

A standard business response is to consider that any move to value added taxes, federal or state, would be on top of, not in place of, burdens of existing taxes. Thus, Business Week (3/4) commented that the Supreme Court decision "has left corporate executives wondering whether revenue-hungry state governments will sock business with costly new taxes." The article quotes a staff member at the Council of State Chambers of Commerce suggesting there was "no question" that other states will be thinking of using the tax. The article concludes, "Corporations can only hope they do better in state legislatures than they did before the Supreme Court."

TAX POLICY ISSUES

Sales Tax Coverage: The report for the Florida Chamber seeks to compare the broadness of the base of the state's sales tax with that of other states. The measure is a crude one. Each state's sales tax collections are adjusted to reflect what would have been collected had the state taxed at 6% (Florida's rate). Local sales taxes are ignored. The resulting collections are compared to personal income. The results appear on Table 5.

The data mostly measure the broadness of the base of individual state sales taxes. However, they also reflect differences in spending patterns -- that is the proportion of personal income residents spending on taxed and untaxed services. Also, they reflect patterns of tourism, with a New Yorker spending money in Hawaii appearing in the Hawaii tax numerator but the New York personal income denominator.

Table 5: Sales Tax Collection Potential At Uniform Rate
As Percent Of Personal Income, 1988

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	7.5%	18	Idaho	3.1%	32	West Virginia	2.4%
2	New Mexico	5.0	18	Iowa	3.1	35	Minnesota	2.3
3	Wyoming	4.6	18	Nevada	3.1	35	Ohio	2.3
4	South Dakota	4.3	21	Kansas	3.0	35	Rhode Island	2.3
4	Washington	4.3	21	Missouri	3.0	38	Illinois	2.2
6	Arkansas	4.0	23	Michigan	2.9	38	Vermont	2.2
7	Arizona	3.9	24	Nebraska	2.8	40	Connecticut	2.1
8	Georgia	3.8	24	Wisconsin	2.8	41	Massachusetts	2.0
9	Louisiana	3.6		**United States**	**2.7**	41	Pennsylvania	2.0
10	Mississippi	3.5	26	California	2.7	43	Maryland	1.9
10	North Carolina	3.5	26	Colorado	2.7	43	Virginia	1.9
12	Florida	3.4	28	Alabama	2.6	45	New Jersey	1.8
12	Indiana	3.4	28	North Dakota	2.6		Alaska	0
12	Tennessee	3.4	28	Oklahoma	2.6		Delaware	0
12	Utah	3.4	28	Texas	2.6		Montana	0
16	South Carolina	3.3	32	Kentucky	2.4		New Hampshire	0
17	Maine	3.2	32	New York	2.4		Oregon	0

Tax Burdens In Major Cities: The District of Columbia government has published its annual comparison of the tax burdens of the largest city in each state. The comparisons are made for families with incomes of $25,000, $50,000, $75,000, and $100,000, based on income, property, sales, and auto taxes. The top ten and bottom ten states in the comparison for income of $50,000 are shown on Table 6.

Table 6: State And Local Tax As Percent Of Income, 1989
Largest City In Each State, Family With Income Of $50,000

Rank	State	Percent	Rank	State	Percent
1	Wisconsin	14.8%	41	Arizona	6.9%
2	Oregon	14.6	42	Delaware	6.4
3	New York	12.3	43	Washington	6.3
4	Michigan	12.2	44	Tennessee	6.1
5	Pennsylvania	11.6	45	Alaska	5.2
6	Maryland	11.5	46	Nevada	5.0
7	Minnesota	11.1	47	New Hampshire	4.7
8	Iowa	10.7	48	Texas	4.6
9	Georgia	10.4	49	Florida	4.5
10	Ohio	10.1	50	Wyoming	3.6
	Weighted Average	**8.5**			

The tax burdens for different income levels can be compared to create a progressivity index for each city. The report does this, concluding that the most progressive overall tax structures are found in Louisiana, Minnesota, California, and Delaware. The least progressive systems are found in four states without personal income taxes -- Tennessee, Washington, South Dakota, and Texas.

Broadening The Income Tax Base: There are periodic proposals that state governments define their corporate and/or personal income tax base more broadly than the definitions used in the federal tax system. Broader definitions of taxable income have been reasonably common for corporations. Examples: "unitary" treatment of corporate income that encompasses some foreign income in the state tax base not included in the federal one and disallowance of accelerated depreciation in the early 1980s. There have also been examples in personal income taxes, such as refusing to allow exclusion of money contributed to IRA and Keogh accounts when they were first established. But taxpayer resistance and desires to reduce taxpayer compliance cost and ease state administrative costs and effort have tended to lead to conformity. So the state definition of income is usually no broader than the federal one. It is sometimes narrower as indicated by tax credits for corporations expanding employment and exclusion of Social Security payments from individual income.

Because states have been reluctant to tax income on a broader base than the federal government, there is a considerable state interest in future federal base broadening or narrowing. In this connection, Making America's Budget Policy: From The 1980s to the 1990s (M. E. Sharpe, 1990) is relevant background. Joseph Minarik (executive director, Joint Economic Committee) traces tax reform efforts in the Congress, emphasizing the tax reform legislation of 1986 which substantially broadened the income tax base. Although current Congressional interest in the subject isn't high, Minarik says, "The potential remains for significant broadening of the tax base." His candidates include tax-exempt industrial development bonds, employer payments for employee health and life insurance, upper income pension and salary reduction plans, and the exclusion of capital gains at death.

Property Tax Issues: In a year when most states are looking for additional revenue, property tax issues in general and property tax relief in particular wouldn't be expected to be major issues. But in some states they are. In Oregon, voters put the issue on the state agenda by requiring a phased reduction of local property tax for schools and mandating that the state replace the lost revenues. In Colorado, voters nearly approved a tax limit measure, drawing the attention of legislators to a similar measure to preempt another try for initiative approval in 1992. In Georgia, legislators put property taxes on the voters' agenda by a constitutional amendment calling for use-value rather than market value assessment. Voter approval gives the issue back to the legislature. A court decision in Utah requiring equal treatment of state-assessed (e.g., railroad and utility) property and locally assessed (e.g., residential) property will require state implementing action. Both a court decision and constitutional amendment will lead the Nebraska legislature to consider property tax matters. Property tax relief has been a major issue for state leaders in Michigan and Wisconsin, but with no results so far. The issues will be revisited in those states, as well as in Kansas where it has ended some political careers and the governor wants to reduce property taxes by a third by broadening the base of the sales tax.

Sticking It To The Suburbs: The confluence of three "good government" concepts is producing a financial shock for residents and local elected officials in some major states. The state already affected most dramatically is New Jersey. Other states, particularly Connecticut and Pennsylvania, may soon follow. The three concepts are: (1) equalization in school finance, (2) state absorption of income-maintenance and other costs falling disproportionately on some areas, particularly central cities, and (3) increases in taxes while avoiding regressive impacts on the poor. New Jersey combined the three concepts: (1) distributing new school aid to favor poorer areas at the expense of rich suburbs, (2) raising money from an income tax increase on higher income persons, and (3) spending much of the new money on low income persons by (a) absorbing local costs disproportionately felt in low income communities and (b) targeting property tax relief to lower income residents. The result has been a tax revolt, which may cause the toning down, though not reversal, of these policy decisions.

Connecticut governor's proposals would have much the same impact. Affluent suburban households will have much more liability for a new 6% tax on income over $25,000 and sales taxes on gasoline, newspapers, clothing, and other items than they will save by a reduction in the sales tax and dividends and interest tax rates. State aid for schools would rise 8% in Hartford, a distressed central city, but would drop over 32% in its affluent suburb West Hartford. Pennsylvania faces essentially the same issue, but proposals for handling it aren't yet clear.

These issues appear in other states, but not in quite the same combination. For example, Texas faces the consequences of changing its school aid formula. But it may opt to pay the costs by a mechanism like expanding the sales tax to services with less redistributive impact than an income tax, although the statewide property tax now being considered would have a massive impact on suburban communities.

The case that state budget cuts disproportionately affect the middle class is made by a recent (2/18) U.S. News & World Report article, "States Under Siege: Financially Pressed Governors Turn Their Guns On Middle Class Benefits." Evidence: (1) concentration of school aid cuts on more affluent districts in Virginia, (2) middle class services affected by cuts such as roads, schools, parks, and more, (3) soaring tuition at higher education institutions, and (4) attempts, such as those in Massachusetts, to deny Medicaid benefits to the middle class.

Development Incentives: Efforts to lure a United Airlines maintenance facility are producing tax concession measures in several legislatures. Oklahoma enacted several bills. One permitted Oklahoma County voters to adopt a 1% sales tax to finance the facility, which they have now done. Another provides various forms of tax exemption (e.g., for purchases of computers, parts, and fuels), and extends an investment tax credit. Virginia's legislature has passed similar incentives, without the local option tax.

REGULATION OF FINANCIAL INSTITUTIONS

Troubled Banks: The problems of financial institutions in the Southwest are being overshadowed by problems in the Northeast, particularly New England. Financial troubles of New England banks and increased regulatory concern over risky loans have discouraged lending. The New England governors have expressed concern that tight money is exacerbating the region's recession. The New York Times (2/17) assessed the most recent financial reports of 12,926 banks to identify those with capital shortages (capital less than 3% of assets) or large portfolios of nonperforming loans (more than 8% of assets). Many of these are relatively small banks (assets under $100 million). Reports took only the largest banks on the Times list to produce the summary shown on Table 7 (next page).

Clearly, the banking solvency problems are highly concentrated in the Northeast, including some small states with some large problems. Much more money is involved in Connecticut (population of 3.3 million) and New Hampshire (1.1 million) than in Texas (17 million) or California (29.8 million). The shift in the locus of troubled financial institutions is not without irony. The bailout of savings and loan institutions used a national fund to deal with problems concentrated in the Southwest and California. Some Northeastern elected officials objected to what they saw as a massive regional subsidy. If the list on Table 7 is indicative of where Federal Deposit Insurance Corporation money, plus any appropriated bailout money, will go, the regional subsidy argument now cuts quite differently.

Insurance Regulation Cooperation Failure? The Wall Street Journal (2/15) reported developments with junk-bond laden First Executive Corp. and its insurance subsidiaries. It said the situation, "appears to be a blow to state insurance regulators." According to the story, regulators of some other states were angry at New Jersey regulators' decision to demand a security deposit from the company -- presumably strengthening the security of policyholders of that state at the expense of policyholders in other states and frustrating the efforts of a multi-state working group of state regulators. The next step was a secret demand for a security deposit by Massachusetts regulators which became public when the company withdrew from doing business in the Bay State.

Table 7: Larger Problem Banks, September 30, 1990

State	Assets Involved (mil.)	Number Of Banks With Low Capital	Many Bad Loans	Both
Massachusetts	$21,230	5	8	5
New Jersey	15,859	0	1	2
New York	13,038	1	6	2
Connecticut	12,360	1	9	5
Pennsylvania	5,638	1	0	0
New Hampshire	3,368	1	4	1
Arizona	2,893	0	2	0
Texas	2,816	9	1	0
Maine	1,450	0	1	0
California	1,307	2	3	0
Rhode Island	971	0	2	0
Virginia	889	0	2	0
Florida	791	2	1	0
Oklahoma	399	1	0	0
Louisiana	303	2	0	0
Kansas	232	1	0	0
Illinois	163	0	0	1
Mississippi	148	1	0	0

A more sanguine view of state insurance regulation is provided by NCSL staffer William Waren in State Legislatures (January). He notes "state regulators and insurance executives agree that state regulation must be improved to prevent insurance company insolvencies." He expects insurance company insolvencies to be an important issue for legislators in 1991 as they seek "assurance that guarantee funds will protect policyholders without draining the state treasury."

Rhode Island Credit Union Bail Out: The Rhode Island legislature has approved the creation of the Depositors Economic Protection Corporation (DEPCO). The plan is for the agency to borrow $300 million in order to pay depositors of institutions that couldn't meet their obligations. Per capita, the deposits in failed institutions were about $1,000 and the state's fund is $300. Half the $300 million would come from bank loans secured by assets of the failed institutions. The other half would come from dedication of half a cent of the existing state sales tax. The plan avoids any immediate apparent pain to Rhode Island taxpayers, but as banking specialist Bert Ely comments, "It doesn't make any difference which pocket you take the money out of -- the taxpayer is going to take the hit."

When all the loans, special funds, and repayments are washed out over time, the present value of the loss to Rhode Island taxpayers would appear to be on the order of $150-300 million, depending on the value the marketplace ultimately puts on the assets of the failed institutions. The earmarking of revenue for DEPCO aggravates the state's serious fiscal problem, estimated at a shortfall of $200 million, equivalent to over $3 billion in a state the size of Florida or Texas.

Bailout Avoided Elsewhere? Texas is taking a lesson from Rhode Island. By order of the state's credit union regulatory body, all state-chartered credit unions must apply for federal insurance by March 1 and obtain it by the end of the year. As they convert, credit unions will withdraw their shares in the $35 million state guarantee fund. The head of the state regulatory agency commented, "No matter how strong your private insurer is, there is still a perception by the public that it needs to be insured by the federal government." Half of the affected 287 credit unions had already reached the same conclusion and had started application for federal coverage. Similar conversions are apparently taking place in Florida, Georgia, Massachusetts, and Missouri. In Missouri, the conversion would be required by legislation that has already passed the House. In Georgia, the action is a result of a decision by the Georgia Credit Union Deposit Insurance Corporation to disband.

Federal Bank Regulation Changes: The Bush Administration and others are making proposals for comprehensive reform of federal banking regulation. Most of the issues are clearly federal -- the size of deposits to be insured, the extent to which banks can engage in other businesses, capital requirements, holding companies, and the like. However, many proposals would further preempt state banking controls by prohibiting states from barring banks from operating unless chartered or approved by the states. Industrial corporations can operate freely in other states but banks, in deference to state laws to protect depositors, cannot.

In a meeting with New England governors, federal regulators, including the chairman of the Federal Deposit Insurance Corporation, indicated that regulatory changes were in the works to improve the capacity of the troubled New England banks (see Table 7) to operate.

SPENDING "OFF BUDGET"

> Budgeting is essential to the effective operation of modern government. ... It is not exaggeration to state that the capacity to govern depends on the capacity to budget.
>
> Allen Schick, The Capacity To Budget

> We rarely fix the roof when the sun shines.
>
> Governor Mabus, State-Of-The-State, 1991,
> discussing Mississippi budget reform

Introduction: One key tenet of state and national finance laws is that administrators cannot spend public money except pursuant to law. Adherence to this concept would drive spending decisions into the legislatures, usually through the budget process. In practice, considerable spending occurs under state auspices that never enters state budgets. Examples are: (1) spending by independent authorities in such fields as housing, toll highways, pollution control, hospital facilities, transit, sewage treatment, and waste recovery, and (2) spending of funds controlled by agencies such as attorneys general in legal settlements, public utility commissions in rate cases, and state university foundations.

Spending Outside The Budget: Considerable national attention has recently fallen on federal practices that take certain spending items outside of the regular budget. The current items of interest are costs of the Gulf War in general and those to be paid by other nations in particular, the costs of the savings and loan bailout, and the costs of a possible bailout of the federal deposit insurance system for banks. But, in general, the federal budget is much more inclusive than state budgets. Both federal and state budgets have a concept of a "general fund" that excludes such special funds as those for highways. Both the federal government and states have a concept of an "all funds" budget, but states have many spending items that are excluded from what is defined as "all." The exclusions have become issues in some states.

Major State Authorities: The largest off-budget spending by state governments is the spending of independent state authorities. Most of these acquire funds initially by issuing revenue bonds and then selling service to the public. The user charges pay operating and administrative costs and interest and principal on the debt. This is the concept of turnpike authorities, port authorities, authorities used by some states to provide utility services, transit authorities, and more. A variant is the financing authority which uses the state's authority to issue tax exempt bonds to finance industrial facilities, hospitals, housing, and pollution control facilities. Another variant uses the authority to finance government facilities -- local ones like schools and state ones like universities and prisons.

In some cases, the authorities have quasi-monopoly positions that allow them to generate revenues well in excess of their costs. This has been particularly true for the many turnpike authorities that have paid off their initial debt, authorities that own key bridges in cities like New York, and authorities with unique access to low cost supplies (e.g., hydropower in New York) or revenues (e.g., water and sewer charges in Massachusetts). These authorities become attractive for relieving fiscal problems by: (1) assuming responsibility for new functions, such as additional segments of roads or investing in economic development and/or (2) picking up additional costs, such as the presumed costs of overhead services by state fiscal agencies. In extreme cases, the state can sell an existing asset, like a road, to the authority. Moves like these have characterized state fiscal plans in Massachusetts, New Jersey, New York, and other states.

Presumed "abuse" of the capacity of authorities to borrow has been an object of concern in New York. In his state-of-the-state address, the governor discussed an undisciplined borrowing process and specifically expressed concern over using the Urban Development Corporation to borrow for prison construction. The comptroller has proposed an amendment to the state constitution that would place a cap on debt outstanding, whether by authorities or direct state borrowing, unless voters approved a higher amount.

His amendment would also deal with the separate problem arising when authorities are unable to cover their obligations. This happened to New York in the early 1980s, with a decision made that general fund money would be used to pay bondholders in order to protect the state's credit. The comptroller's amendment would eliminate "moral obligation" financing.

Money Not Entering The State Treasury: State constitutions and laws requiring appropriations typically apply to funds held by the state treasurer or "state funds." Those seeking to avoid the appropriations process (and the controls over purchasing and public disclosure that go with it) need to find a way to collect and disburse money without falling within such definitions. Some categories:

- Organizations which themselves are not government but which may receive and spend public funds much as a contractor or grantee would do. Examples are inaugural committees, endowments such as those for the arts or wildlife preservation, quasi-public corporations such as Minnesota's Business Partnership, and more.

- Organizations that are clearly state government but which establish other entities that receive and disburse funds without ever considering them government receipts. The simplest example is the office coffee fund, but there are more important others such as university foundations and student activity funds.

Off-Budget Financing In Maryland: The issue led to the February resignation of the Secretary of Health and Mental Hygiene, the state's largest spending department. The problem was legislative reaction to the management of the Maryland State Games Foundation, Inc., theoretically no more a state agency than an office coffee fund. The Foundation was established as a private nonprofit entity to raise money for various sports competitions. But its executive director was the state employee who headed the health department's state games project and office space was provided by the state. The Foundation's income came primarily from state grants. It allegedly misspent money by renting a beach condominium, paying an employee while in jail, and in other ways.

Off-Budget Financing In South Carolina: Alleged abuses, such as renting $800-a-night hotel rooms, by the Carolina Research and Development Foundation led to the resignation of the University of South Carolina president last year. This year a new problem has caused the governor to ask the state police to investigate. After some local news organizations won their suit to get access to the Foundation's records, they found many of the records had been destroyed.

Off-Budget Financing In Virginia: Governor Wilder's inauguration was an immense financial success, reportedly leaving about $1 million which the governor plans to use as personally controlled funds for such purposes as assisting in election campaigns and, some say, running for President. He has refused to release information on who gave how much to the inaugural committee, reflecting the perspective that it was a purely private body. Taking the position that the inauguration is a state function, the legislature passed a bill requiring that future statewide elected officials disclose inaugural contributions and spend money only on inaugurations, but they would be permitted to keep any residual as campaign funds, not turn it over to the general fund as provided by an earlier version of the legislation.

The Politics Of Foundations: State officials have found handling the foundation issue to be tricky. On the one hand, the foundations often get money from state government. When they don't, they get money because of a relationship to something a state does support, such as a state university. This argues for auditing by the state, if not appropriations or purchasing and conflict of interest controls. On the other hand, most of the foundations do live out of donated money. The issues often pit heavy hitters in state politics as foundations are typically closely associated with state universities, economic development, public broadcasting, and governors' mansions.

Off-Budget Spending And Budget Reform: Allen Schick's, The Capacity To Budget (Urban Institute, 1990) is an assessment of federal, not state, budget processes. But it reflects criticisms of budget processes which many states share with the federal government. His summary comments reflect concerns of budget professionals with devices like off-budget handling of government spending.

> When budget procedures are stable, one can be reasonably confident that the same rules for estimating the budget effects of legislative decisions will be continued from year to year. Stability in scorekeeping rules is valued because it facilitates inter-year comparisons and enables those making the decisions and those affected by the budget actions to have confidence in what they are doing. Because legislative scorekeeping rules are self-enforced,

> they are sometimes manipulated for short-term advantage. The machinations undoubtedly escalate when fiscal stress intensifies.
>
> The integrity of budget accounts is at great risk when the scorekeeping rules are made up each year... Without changing a single program or policy, deficits can be made to vanish or savings to materialize by changing the way transactions are accounted for in the budget. Placing items in or outside the budget, delaying or advancing payment dates, and manipulating the sale of assets are old tricks, but one has the impression that they have been used on a broader scale in the 1980s than previously.

LEGISLATIVE MANAGEMENT

Legislative Issues: Predictably, fiscal issues were named as the top priority in a new survey of legislative leaders. Education, particularly education finance, was ranked second. Third was the environment -- a complex of issues including solid waste, land use, and growth management.

Fourth, the leaders identified reapportionment and redistricting. Legislators handle their own redistricting in 39 states, with special boards or commission the pattern in the other eleven. Besides redistricting legislatures, the 44 states with more than one U. S. House member have to redraw Congressional districts. All but three of these states decide the issue in their legislatures.

NCSL President John Martin (ME) predicted "contentious 1991 legislative sessions." He also noted some of the legislative management issues not highlighted in the survey:

> At the same time, legislatures face additional challenges as there are growing attempts to restrict the authority and options of legislatures through term limits and increased use of the initiative process. There also is a growing concern about campaign finance and ethics issues.

This article covers some of those topics including some aspects of legislative pay and its relation to tax treatment of expenses, legislative staff cutbacks, and various resources for dealing with legislatures.

Legislators' Taxes and Cost of Living Differences: A little known benefit of being a legislator is the special federal law dealing with legislator's expenses. Under the law applicable to everyone, legislators don't have to pay taxes on their ordinary and necessary expenses associated with doing their jobs. They don't pay these taxes because: (1) they account to the state on expense forms and are reimbursed only for expenses they convince their employers to pay or (2) they don't file expense forms with their states, but do maintain expense records and deduct the expenses. The general rule for all taxpayers is that expense allowances paid without the submission of expense forms are treated as income, just like salary, though expense deductions can be taken against that income to the extent they exceed 2% of adjusted gross income. All taxpayers who spend considerable time at a job away from "home" and maintain any kind of residence at the job site (e.g., a permanent hotel room or shared apartment) run the risk of having IRS decide their tax home is where they work, so that no commuting expenses between "home" and the tax home (like a state capitol) are deductible.

Federal legislation permitting more favorable treatment for state legislators was enacted on a temporary basis in 1976, extended thereafter, and made permanent in 1981. Legislators who live more than 50 miles from the state capitol benefit from a special rule protecting them from having the state capitol declared as their tax home. Also, they can elect a special per diem rate. The rates are tied to federal employee per diems. Those currently in effect are shown on Table 8.

Table 8: Daily Per Diem Exclusions For State Legislators, 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Hawaii	$126	18	Minnesota	$82	35	Missouri	$74
2	Massachusetts	121	19	North Carolina	82	36	Oklahoma	73
3	Alaska	117	20	Virginia	82	37	Florida	72
4	New Jersey	114	21	Wisconsin	82	38	Idaho	72
5	Georgia	108	22	Texas	81	39	Maine	71
6	Maryland	104	23	New Hampshire	78	40	Vermont	71
7	Rhode Island	100	24	Tennessee	78	41	Alabama	70
8	Colorado	99	25	Washington	78	42	Kentucky	70
9	New Mexico	99	26	Michigan	77	43	North Dakota	70
10	Connecticut	94	27	Iowa	76	44	Kansas	69
11	New York	89	28	Louisiana	76	45	Wyoming	69
12	California	88	29	Mississippi	76	46	Nebraska	67
13	Indiana	88	30	South Carolina	76	47	Montana	66
14	Pennsylvania	88	31	West Virginia	75	48	Nevada	66
15	Utah	86	32	Arkansas	74	49	Oregon	66
16	Ohio	85	33	Delaware	74	50	South Dakota	66
17	Arizona	83	34	Illinois	74			

Encouraging Longer Legislative Sessions: The federal law has a definition of the number of days the per diem may be claimed that creates strong incentives for "pro forma" or "skeleton" sessions and for committee meetings. Basically, a legislator may claim per diem when the legislature is in session, for short periods between session days, and for committee meeting days. The legislator does not need to travel to the state capitol to claim the per diem for a particular day.

The advantage of the arrangement can be substantial. **Reports** calculated the difference between normal tax treatment and the special rule for a hypothetical legislator and found a gain of $5,000 to $6,000. In Ohio, most Senators could deduct $26,726 in 1990. The Senate had 121 session days arranged in such a way that they were deemed for tax purposes to be in session another 227 days, for total days of 348. The Boston Globe (2/3) checked the records of one prominent Massachusetts legislator and found that he claims state per diem for about 150 days a year, presumably the number of days he was on state business, but takes a federal tax deduction of about 360 days a year. In late January California's Board of Control approved increasing legislators' rate to match a recent change in the allowable federal maximum, permitting the maximum to rise to $18,850 a year according to press reports.

Legislative Pay And Ethics: Texas legislators are under considerable pressure to adopt strict ethical standards, including prohibitions against taking things of value from lobbyists like vacation trips, entertainment, and meals. There has been press criticism of examples of these arrangements and others such as acceptance of retainers by lawyer-legislators. Texas has a larger-than-average problem in dealing with the many calls for stricter ethical standards. Many legislators feel that added job benefits are essential to recruit and retain legislators in general and part of their appropriate price of service in particular. In short, they feel underpaid. The result, according to the senator who is pushing one ethics bill: "You're not ever going to have a completely good ethics bill until you get salaries up."

Texas legislators are scheduled to be in session 140 days every other year. But they tend to meet in special sessions in the year no regular session is scheduled and to have issues with heavy time requirements as they have had the last several years with Workers Compensation reform and school finance equalization. By one compilation, the legislature has been meeting more often than the Congress. But legislative pay of $7,200 a year was last changed in 1975. The last attempt to raise it -- which involves a constitutional amendment and thus a popular vote -- was in 1989, when voters rejected it by a 2-1 margin. As Texas legislators see it, they are serving the third largest state, but aren't getting compensated accordingly, as shown on Table 9 (next page).

Legislative Staff Layoffs: California's Proposition 140, the initiative approved by voters in November, required a reduction of nearly 40% in the legislature's operating budget ($190 million) as well as limiting legislative terms. The announced staff reductions in the Senate are 200 of 1,000 employees and in the House 440 of 1,500 staffers.

Table 9: Legislator Compensation In The Ten Largest States, 1991

State	Annual Pay	Per Diem	Other
New York	$57,500	$75	
Pennsylvania	47,000	88	Plus $10,000/yr. exp.
Michigan	45,450	0	Plus $8,500/yr. exp.
California	40,816	88	
Ohio	38,482	0	
Illinois	35,661	74	
New Jersey	35,000	0	
Florida	21,684	50	
North Carolina	11,124	81	Plus $465/mo. exp.
Texas	7,200	30	Out-of-session exp. allowance = $85

Legislative staff who left voluntarily by January 31 got substantial benefits. First, they got four months severance pay with an extra month if they had more than two years service. For those who took other state jobs without a break in service, this produced some press criticism, but legislative leaders argued there was no basis for making severance pay less restrictive for those taking California jobs than those taking private sector jobs.

The legislature is challenging the initiative in court. The California supreme court has shown some willingness to reject initiatives as (1) covering more than one subject or (2) using the initiative process to make fundamental changes in the constitutional framework. This suggests the lawsuit has some prospect for success despite reluctance of the court to reject an initiative approved by voters.

Ethical Standards: The most recent Gallup Poll on ethical standards didn't rate state officials last, but didn't rate them highly either. Respondents were given a list of occupations and asked, "How would you rate the honesty and ethical standards of people in these different fields -- very high, high, average, low, or very low?" The percentage rating each group very high or high is shown on Table 10.

Table 10: Percentage Rating Honesty And Ethics High Or Very High

Occupation	Percent	Occupation	Percent	Occupation	Percent
Clergy	55%	Bankers	32%	Building Contractors	20%
Medical Doctors	52	Journalists	30	Congressmen	20
College Teachers	51	Business Executives	25	**State Officeholders**	**17**
Engineers	50	Senators	24	Labor Leaders	15
Policemen	49	Lawyers	22	Stockbrokers	14
Funeral Directors	35	Local Officeholders	21	Car Salesmen	6

State Government Relations: Leveraging State Government Relations is a 214-page compilation of materials developed by the Public Affairs Council (1019 19th St., N.W., Washington, DC 20036). Its concern is how corporate and trade association executives deal with "the newly powerful decision-makers in our state capitols who have assumed many of the political and governmental prerogatives once jealously husbanded by legislators in Washington and by federal regulatory agencies." Most of the essays deal with the profession of state government relations for the corporation -- how to do it, how to get cooperation within companies, how to monitor legislation, how to measure the results, and more.

The interest in state government relations has increased apace with the increasing number of decisions being made in state capitols. This is hard to quantify, although the Wall Street Journal used comparisons of the number of registered lobbyists in an article last year (5/30). For example the number of lobbyists registered in Iowa doubled between 1984 and 1988 while the number in Washington and Wyoming grew by a third.

The Government Research Service (701 Jackson, P.O. Box 2041, Topeka, KN 66601) has issued the sixth edition of its State Legislative Sourcebook. It is summarized in one of the essays in Leveraging by Margaret Rita (Tobacco Institute):

> If you are responsible for monitoring and tracking legislation, you should have it. It contains all the basic information you need on a state's legislative organization, length of sessions, where and how to get bill copies, and so forth. It also contains the telephone numbers of the state capitols, bill status and reporting services and local contacts for information which official state offices do not readily provide.

The firm also publishes a bibliography of state "blue books" and similar publications that list state officials, facts about a state, telephone numbers, statistics, and other information which varies from state to state. For those wanting even more detail on sources of information about legislatures, it publishes a newsletter, Legislative Information Alert.

Tracking And Predicting Legislation: NCSL has released Enactments 90 -- no analysis, little description, but citations of laws passed by state legislatures last year. The document is impossible to use without supplemental sources because it gives only the subject matter of action (e.g., "Arts In Education, Funding") not the action (e.g., increased, decreased). State Issues 1991, also from NCSL, reflects 1,400 survey responses from legislators and legislative staff. The result is a compilation of elaborate statistical matrices of states and issues, highlighted by short summaries prepared by the NCSL staff. The problem with a survey of so many people on so many issues is that the results can tell readers less than they knew already. For example, the survey results indicate, "arts agency funding will claim the attention of lawmakers in 38 states in 1991." The actual number is likely to be 50, as arts budgets will be voted upon or previously enacted budgets or earmarking will be at risk from budget cuts in every state. The missing 12 responses may suggest more about the survey than about arts funding issues. But by ignoring much of the 114 pages, readers can concentrate on what remains -- about a 25 page booklet by the NCSL staff summarizing this year's issues, a useful summary for many readers just to get a feel for the overall legislative agenda.

MISCELLANY

California Water Rationing: "I will not hesitate to assume emergency powers if such powers become necessary to protect Californians from the worst effects of the drought," said Governor Wilson in a mid-February press conference. The actions being considered, such as controlling water use from privately owned water sources, are a reminder of the inherent police power of state governments. For the moment, the governor is seeking to establish a $100 million drought fund, encouraging communities to cut their water use, and establishing a voluntary "water bank" to transfer from those who may be willing to sell (e.g., rice farmers) to those who want to buy (e.g., municipal water suppliers short of water because their supplies from federal and state reservoir and aqueduct projects are being cut). The drought, besides being a problem in its own right, is likely to add to the state's fiscal problems by increasing spending and cutting into revenues from water-related activities like farming.

Disappearing Budget Cuts: As in 1982-83, many of the announced budget cuts aren't being fully implemented. Obstacles include: (1) reconsideration by governors in light of objections, (2) granting of large numbers of exceptions, (3) conflicts with collective bargaining agreements, (4) litigation, particularly in social service programs, and (5) lack of legislative approval in circumstances where it is required.

The record for reconsideration by governors is probably being set by Governor Schaefer of Maryland. He has announced and reconsidered: (1) cutting back general assistance (state-funded welfare), (2) reducing kidney dialysis services, (3) eliminating youth camps, (4) forcing state workers to put in a 40-hour week, and (5) laying off over 1,000 workers. Critics suggest he is trying to build pressures for a tax increase. The record for having FY 1991 cutbacks tied up in the legislature is being set in Maine where the legislative leaders (D) and governor (R) have sharply-differing ideas about appropriate ways to close a massive deficit.

Divestiture: California's health director has asked the trustees of state universities and state retirement systems to divest their portfolios of stocks of tobacco companies. Such action has been taken by a few universities (e.g., City University of New York), but **Reports** is unaware of any pension plans that have made the move. Divestiture of stocks of companies operating in South Africa remains an issue in some states (primarily state universities) and a policy in others. There are a variety of other issues where divestiture is suggested (e.g., munitions manufacturers, companies operating in Northern Ireland). The impact of such moves on the policies involved (e.g., apartheid, tobacco production) isn't easily measured.

The economic returns are in from nearly a decade of divestiture of securities related to South Africa by some states and experience of mutual funds which avoid or select securities for social policy reasons. Those results confirm what economic theory would suggest. So long as those selling (or buying) securities for any non-economic reason is small relative to total buyers and sellers, the actions of the other market forces will offset the actions of the few. As a result, proponents and opponents of divestiture in any particular state claim too much. There isn't a noticeable impact on companies' ability to raise equity capital and thus no economic pressure, though there may be psychological pressure. Also there isn't a loss in the rate of return realized on pension plan or university endowment portfolios, though there are one-time transaction costs if securities are sold as distinct from new purchases being avoided.

Federal Impacts On State Finances: A suit recently filed by Kansas against the U.S. Department of Agriculture is a reminder of concerns of state officials that the federal government uses its power to reduce the price of its operations by exemptions from state and local taxes. To the extent this happens, it requires higher taxes on everyone else. Examples are the mandate that states not apply their sales taxes to purchases made with Food Stamps, mandated exemption from sales taxes of sales to the federal government, and protection against property taxes accorded certain government contractors. The Kansas concern is over the private insurance companies that write about 85% of the crop insurance policies. In June, the Federal Crop Insurance Corporation issued a regulation that the private crop insurers would henceforth be exempt from state regulatory requirements and premium taxes. The decision will cost Kansas about $500,000 a year.

Income Taxes: The governor of Tennessee recently joined the governor of Connecticut in proposing a personal income tax in a state that has been avoiding one. Both proposals would lower sales taxes on which the two states have been relying heavily.

Items: Louisiana's tax-free shopping program is now more than a year old. The concept is to rebate the substantial state and local sales taxes to foreign visitors who buy in Louisiana. The program gets a favorable review from the New Orleans Times-Picyaune (1/27), which concludes it has drawn considerable extra business. North Dakota has a similar plan for visiting Canadians. Maryland's Governor Schaefer turned what might have been an isolated decision [illegible] a lame-duck governor into what might become a trend when he followed Ohio former Governor Celeste's lead in pardoning a group of women convicted for killing or assaulting men who had battered them. For details and speculation on action by other states, see the New York Times (2/21).

TECHNICAL NOTES

Higher Education: The data on appropriations per student and percentage of operating costs paid by tuition are from Research Associates of Washington (2605 Klingle Rd., N.W., Washington, DC 20008), State Profiles: Financing Public Higher Education 1978 to 1990. This 217-page volume is an outstanding reference for state-by-state data on all aspects of higher education finance.

Tax Recommendations For Florida: The Florida study was commissioned by the Chamber of Commerce Foundation (136 S. Bronough St., P.O. Box 11309, Tallahassee, FL 32302) and performed by SRI International. The study of Florida's economic development potential and tax structure was published as a 143-page report, Crossroads: Designing Florida's Tax Structure.

Large City Tax Burdens: Tax Rates And Tax Burdens In The District Of Columbia: A Nationwide Comparison is produced by the Office of Economic and Tax Policy, Department of Finance and Revenue, Government of the District of Columbia, 300 Indiana Ave., N.W., Washington, DC 20001. The new data closely resemble the previous year (States In Profile, Table D-25 and, for the progressivity index, Table D-26). Particularly for the lower income household comparison, the data are extremely sensitive to assumed housing values. Families with income of $50,000 are assumed to live in a house worth $125,597 in the median state. The assumed value was only $61,000 in Detroit and $72,000 in Philadelphia but $247,000 in Los Angeles and $275,000 in Honolulu.

Legislative Management: The views of legislative leaders appear in Leaders' Outlook 1991, the result of an NCSL survey of state legislative leaders. The per diem tables are from the NCSL publication Issues In State Legislators' Income Tax. NCSL maintains a constantly updated table of legislative pay and per diem for the 50 states. The ten state version used in Texas and appearing in this issue is from the Austin American-Statesman (2/4). The ethical ratings are from a Gallup Poll in early 1990. It was reported in The American Enterprise (January/February 1991).

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SPR

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Many of the state fiscal problems are being shifted to local governments, sometimes with relief from mandates or new local option taxing authority.

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Tourism promotion continues to offer potential for economic development, at least as many state officials see it.

o Travel and Tourism p. 18

Federal aid has become a less important factor in state budgets, but still redistributes purchasing power among states. Federal mandates remain a factor contributing to state budget problems.

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Miscellany deals with court decisions about taxes on truckers and Indian reservations. Technical notes indicate data sources.

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March 1991 (Second of Two March Issues)

FISCAL DEVELOPMENTS

Introduction: Fiscal problems are proving more intractable than many state officials asserted in their campaigns and reaffirmed in their post-election comments. With no economic improvement and frustration of attempts to balance current year budgets, some FY 1991 deficits will carry over into FY 1992. In FY 1992, "structural deficits" and left-over FY 1991 problems combine to make sharp cuts necessary if tax increases are to be avoided.

Balancing FY 1991 Budgets: In December and January, governors in over half the states announced austerity measures to bring their current year budgets into balance. Some parts of these plans aren't producing the savings promised when they were announced.

Plans that have the effect of cutting employee wages have run into problems nearly everywhere. The New York plan for furloughs evolved into a plan for wage deferral In Rhode Island, where about 85% of workers are unionized, the governor's plan for pay deferrals is opposed by the labor organizations which are seeking to block it in court. The governor is threatening to increase the number of layoffs, as well as shutting down government 36 days in the next 16 months if the plan is blocked. The first one-day partial shutdown of state activities occurred in March. In Massachusetts, Maine, and several other Northeastern states, the overall picture is comparable, but the details are different. The key difference between the furlough plans and partial shutdowns of state activities is that large numbers of workers, like corrections officers, would typically be exempt from the shutdowns.

Other budget cutting measures are experiencing problems as well, with litigation often delaying if not preventing reductions in welfare, Medicaid, and social services. In some states, like California and Maine, legislators have been reluctant to accept cuts recommended by governors.

In many states, the revenue news hasn't been good either. There are major downward revisions in California and the Northeast, while examples of unexpected revenues in other states are rare.

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Balancing FY 1992 Budgets: In the larger states, not many final new (FY 1992) budget decisions are being made this spring -- the seasonal hiatus between governors' presentations of budgets and final legislative decisions on spending on taxes. But news is trickling in that will affect the outcome. Most of it is bad. All of the bad news affecting FY 1991 carries into FY 1992. Any FY 1991 shortfall enters FY 1992 automatically as a lower balance (or larger deficit). The problems affecting FY 1991 -- litigation, factors causing lower-than-expected revenue, growing caseloads, etc. -- usually will affect the FY 1992 projections as well.

A complicating factor is the environment in which the FY 1992 cuts are being considered. Policies, such as across-the-board cuts, may seem acceptable when implemented for several months as temporary measures to restore budget balance. But they may be less acceptable to constituents, legislators, interest groups, and agency heads when considered on a full year basis. There are wide gaps between governors' FY 1992 spending reduction plans and what may prove acceptable to legislators in California, Maine, Massachusetts, and Michigan -- as well as other states.

Structural Deficits: Current state fiscal problems aren't temporary recession-related ones according to new looks at the future in several states. These states are instead facing "structural deficits," persistent tendencies for spending for existing activities to outrun revenues from current taxes. In New York, the budget office's five year review shows particularly rapid growth in foster care, education of handicapped children, and Medicaid. In Massachusetts, the governor has been discussing a structural deficit, reflected in the fact that the state has been running unbalanced by $500 million to $1 billion for each of the last three years, despite tax increases.

The argument that a "structural deficit" exists is stronger in California than many other states. The underlying workload driving education costs, the number of students, is stable or dropping in many states. In California, it is rising rapidly, with a K-12 increase of 4.3% factored into the new budget. The sharp enrollment gain also appears in higher education with average annual increases over the past six years of just over 2%. On top of these problems driving spending, California's revenue growth is slowed by indexing of the personal income tax. Indexing is designed to prevent inflation from automatically increasing the percentage of income taken by graduated income taxes. It provides automatic increases in exemption and/or bracket amounts to reflect price level changes. The federal government and a handful of states use it.

In its assessment of the FY 1992 budget, the California legislative fiscal office looked ahead to FY 1993 and FY 1994, concluding that current service spending would grow 10% in each year. Current service revenue growth will be substantially less -- with how much less depending on economic assumptions. As a result, the

Legislative Analyst foresees a structural deficit of about $5 billion in FY 1993 and over $6 billion in FY 1994.

Legislative-Executive Roles: The need for cutbacks in approved FY 1991 budgets and for cost-cutting in FY 1992 is revealing long-standing disagreements about executive and legislative power.

One conflict is over the authority to set fees. Some states give the executive branch broad authority to set fees for such items as birth certificates, copies of tax returns, and applications for state permits. Others cover almost all fee decisions by legislation. Many states have inconsistent, but arguably appropriate patterns. They set economically important or politically sensitive fees, such as auto registration and hunting licenses, by statute but let the executive branch set other fees based on criteria like covering the cost of service. Some governors have been seeking more fee setting authority. The issue is a long-standing one in Massachusetts. Governor Dukakis (D) won broad fee-setting authority from the legislature (D-led) in 1988 as part of a temporary budget-cutting plan. Now Governor Weld (R) wants to repeat the process. The House Republican leader opposed the action in 1988 and announced he will oppose it again this year.

Legislative Sessions: Two states, Kentucky and Virginia, have concluded their legislative sessions for the year.

Kentucky had no regular session scheduled and, with a large tax increase last year, has no major fiscal problems. It has concluded a special session dealing with such subjects as Workers Compensation reform and tax breaks to promote economic development.

Virginia's major legislative sessions are in even-numbered years, with off-year sessions limited in length -- a limit the legislature this year voted to relax by seeking a constitutional amendment allowing recesses during the session. Governor Wilder and legislative leaders agreed to cut spending in the FY 1992 budget enacted last year rather than raise taxes. Much of the pain was taken out of the adjustments by measures that neither cut operating spending nor raised taxes: (1) increasing the assumed return on pension fund investments, (2) using lottery money to support the regular budget rather than special projects, (3) relying more on tuition and less on appropriations to support universities, and (4) selling the state's interest in a railroad.

Reorganization And Cost Saving: Reorganization is being pushed as a budget-balancing device by some governors and recommended in other states by special study commissions. Some of the common proposals are: (1) reorganizing Medicaid administration by putting it in a separate department or combining it with health functions while severing it from welfare functions, (2) reducing the number of agencies by eliminating some small independent boards and commissions and consolidating small professional licensing functions in an umbrella licensing/regulatory agency, and (3) replacing boards and commissions with a single agency head. Other reorganizations -- such as those concerning elected v. appointed state superintendents of education -- are under consideration, but generally in the name of efficiency and education quality rather than cost saving.

Reorganizing Rhode Island: The Rhode Island Public Expenditure Council has an extensive list of recommendations. One is creating a chief state financial officer with control over budget, accounting, taxation, and auditing. Conversely, some New Jersey legislators are seeking to dismantle the office of treasurer, reasoning that the excessive power of the office which has many of these functions led to the unpopular tax increase and local aid changes made last year. Other RIPEC recommendations: (1) a management information systems czar, (2) a cabinet council on human services, (3) a biennial budget, (4) consideration of a department of public safety, and (5) improved personnel management with many suggestions for how to achieve it.

Reorganizing West Virginia: Some reorganizations reflect principles long in effect in other states without apparent problems. For example, this year the West Virginia legislature is processing legislation to merge the beer commission and the liquor commission. The governor has administratively already achieved one economy by appointing the same individual as the head of both agencies.

Reorganizing Mississippi: Mississippi's governor pushed reorganization in 1989, suggesting that over $30 million could be saved. The legislature adopted part of his plan including creating a Department of Administration and Finance and a Department of Human Services, each consolidating a number of smaller agencies. While the governor points with pride to the actions taken and says they have held down cost, observations by legislators and the Performance Evaluation and Expenditure Review Committee suggest that cost changes associated with reorganization are inherently minor unless major changes in the number of personnel are involved, which they haven't been so far.

Reorganizing Maine: While Mississippi implements its Department of Human Services, Maine legislators are considering dismantling their Department of Human Services to create new agencies -- a Department of Families and a Department of Health and Rehabilitation. A Department of Families bill was passed last year but vetoed by the governor. Both the legislature and the governor have produced commissions examining what to do next. Maine legislators are also considering a proposal that would reunite the financial and administrative functions that were split in 1986. Along with practically all budget and finance issues, reorganization has become a partisan issue in Maine between the legislative majority (D) and the governor (R). The governor is currently pushing creation of a "Commission on Government Efficiency and Organization" that would consider reorganization issues and report next year.

Reorganizing New Jersey: Massive claims are being made for the benefits of the reorganization of New Jersey government recently proposed by the governor. The plan is supposed to result in elimination of 3,000 jobs, plus about 38 staff members and hundreds of volunteers that would be affected by eliminating about 50 boards and consolidating another 20. The major shifts: (1) combining environmental protection and energy, except public utility regulation, (2) merging personnel functions into the Treasury Department, which has budget as well as traditional treasury responsibilities, and (3) combining financial regulatory agencies with commerce department functions. Consolidating business regulatory activities in a commerce department is one of Governor Engler's proposals in Michigan.

College Closings: State budget stringency, higher tuition, and relative stability in enrollments at levels sometimes below expectations of campus planners have produced some interest in closing college campuses as an economy move. However, closings are rare. The local campus is a matter of civic pride and a symbol of economic development for the local community and its legislators. It impacts some students, however few, whose education plans would be dislocated by closing. An argument is often made that the savings from closings would be minimal, because roughly the same number of students would have to be taught somewhere else at state expense. In states with predominantly white and predominantly black institutions, there is often fierce opposition by the alumni, staff, and students of the predominantly black institutions to mergers. This opposition has prevented implementation of merger plans in Louisiana despite strong support from the governor.

There are a few states with active college closing issues. In West Virginia, the perpetual dispute over whether the state needs, or can afford, three medical schools is coming to a head in this year's budget process. In Massachusetts, the governor has established a commission to examine closings. A transition report to the governor suggested closing several community colleges and the Massachusetts Maritime Academy. In North Dakota, the state institutions are listed in the constitution. A state supreme court decision holds that any institution listed must be "adequately funded." This prevents consideration of changes in a state where there have been major population declines, so a proposal to take institutional names out of the constitution is again before the North Dakota legislature this year.

Health Care: Interest in "bootstrap financing" of Medicaid continues with the proposal of Florida's governor to raise the tax on hospital receipts from 1.5% to 3.5% with funds to be used for indigent care. There is local debate over whether the proposal can be considered a tax increase or not. The governor calls it a hospital assessment. Arkansas is in the process of enacting what amounts to a state tax on the state share of Medicaid reimbursements to hospitals, with proceeds to be plowed into matching more federal Medicaid money.

West Virginia's House passed by voice vote a bill dealing with a "Disproportionate Share Fund." Kentucky's governor recently signed a bill taxing health-care providers to provide the state with money to match federal Medicaid funds.

The types of health care proposals that have been considered by legislatures over the past several years are being reintroduced, though with much less chance of enactment in the current fiscal environment. One type, with broad labor support, emulates the Canadian system and requires substantial added funding to cover the uninsured, usually proposed to be financed with a payroll tax. An example is "Universal Health Insurance for Ohio," legislation sponsored by 29 Members of the Ohio House. Its sponsors claim that it would cost $23.8 billion a year compared to current costs of $27.5 billion, though consumers would presumably buy some discretionary health care services, like cosmetic surgery, over and above the plan. Every Ohio resident would be a plan member entitled to free services. While service would be free the plan wouldn't -- requiring a 9% payroll tax on employers, a 1.25% payroll tax on employees, a big hike in alcohol and tobacco taxes, and resources now flowing through Medicare and Medicaid.

Another type, usually backed by health care providers, makes little or no change in the health care system but puts more money into it. "Health Access Florida," from the Florida Medical Association, is an example. It calls for increased state spending for Medicaid and reduced state revenues as a result of new employer tax credits.

One of West Virginia's major issues this year illustrates the complexity of state involvement in hospital rates. The state is one of those that has retained state rate-making with legislation up for renewal this year. Mountain State Blue Cross is campaigning, including spending about $1 million in advertising, against state rate-setting. The organization calls it price fixing. The hospitals, traditionally opposed to rate ceilings, have reversed their prior position to support continued state control. Their concern is that Mountain State would use its buying power to force concessions in hospital rates.

Tax Increases: This will be a big year for state tax increases according to a new assessment by State Budget & Tax News (3/11). The publication predicts that major state tax increases will affect 62% of the nation's population through actions by about half the states. It suggests there will be no dominant pattern in which taxes are chosen for increases -- with business taxes, personal income taxes, sales tax rates, and broadening of the sales tax base all playing a part. The predictions imply that there will ultimately be major increases in about eight states where the governor hasn't proposed increases.

Two legislatures have already increased taxes. Rhode Island increased the personal income tax (from 23% of federal liability to 27.5%), the corporate income tax (11% surtax on present state liability), and the gas tax (26 cents, up five cents). The scheduled reduction in the sales tax was also eliminated. Arkansas raised the sales tax and motor fuel taxes.

Sales Tax On Services: The Massachusetts sales tax on professional services (e.g., attorneys and accountants) remains a subject of controversy. No other major state has such a tax, but proposals for similar measures have been offered elsewhere.

The tax was enacted over business opposition last year, as part of the unsuccessful efforts to balance the Bay State budget. In his campaign, Governor Weld (R) included a pledge to seek its repeal. He sought repeal before the tax was scheduled to become effective. Instead, the legislature deferred the effective date until March to consider it in the context of the governor's budget recommendations. The governor presented a budget which legislative leaders (D) saw as raising questions about whether some of the revenue raising devices and proposed cuts were appropriate. They sought legislation deferring the effective date until July, also to wait to get a feel for the state's overall fiscal position. The governor pressed for outright repeal and won.

The governor maintains that the state budget can be balanced without the service tax and without any replacement tax. Some legislators are concerned that the budget recommendations achieve balance by shifting costs to subsequent years by devices like lower pension contributions and what amounts to sale-leaseback of state assets. Local officials are concerned that the budget avoids state tax increases only by cuts in local aid that will force local tax increases. Those interested in state spending for education, social services, and other state functions argue that cuts are too deep. As a result, it is possible that Massachusetts will increase taxes -- the state is still on SB&TN's TaxWatch. But repeal of the tax on professional services is likely to focus attention on other forms of tax increases, such as the increase in the sales tax rate that has been proposed by some interest groups.

Tax Positions Of Organized Business: The willingness of some business organizations to support broad based taxes is underlined by a recent decision by the Illinois State Chamber of Commerce. Two years ago the Chamber fought the increase in the flat rate personal income tax from 2.5% to 3.0% and a proportional increase in the corporate tax. They passed, but controversy over whether the increase should be extended this year was a major factor in the 1990 gubernatorial campaign. Now the Chamber is backing extension. The Arkansas legislature appears likely to pass an increase from 6% to 6.5% in the top bracket corporate income tax rate that is endorsed by several business groups. Funds would be used for vocational education.

Income Taxes: The prospects for new state income taxes remain mixed. In Connecticut, a recent poll indicates 70% of the population oppose the governor's proposal to begin taxing income. Governor Weicker is pleased with the reaction to his tax plan and budget cutting proposals:

> Everybody is pissed off. Not one side or the other, but everybody. Now doesn't that tell you this plan is fair.

In Tennessee, the apparently well-orchestrated effort to provide a majority for an income tax seems to be on schedule. But the issue is quiet in other states for now. In New Hampshire, officials are looking for new ways to tax business. In Texas, the interest is in a regional property tax. For taxpayers and those interested in schools, plus a state supreme court seeking equity in school finance, the tax is the equivalent of a statewide property tax. Legislators hope legally it isn't, as such a tax would be unconstitutional in Texas. The lieutenant governor recently announced his support for a Texas income tax.

Twisting In The Wind: Many state officials think they are dealing with tough, indeed unprecedented, problems this year. But some problems look less onerous when compared to worse situations. In that spirit, the candidates for most difficult problems this year are: (1) New Jersey where elected officials have to explain how they have both a major unpopular tax increase and massive cutbacks in some state spending, (2) New York where extreme state and local tax burdens make another tax increase unthinkable, but past spending patterns made massive cutbacks unthinkable as well, (3) Massachusetts where the gulf between the governor and the legislative majority is massive, (4) California where the gulf isn't as large, but a solution requires a two-thirds vote, (5) Arizona where distrust of public officials is about as high as anywhere in the country, and (6) West Virginia where the economy simply won't support the level of public services of the past or of other states.

INDEX OF STATE ECONOMIC MOMENTUM

Introduction: The latest Index of State Economic Momentum (Table 1) confirms the relative deterioration of the New England states and the continuing strong performance of the West. The Index, prepared quarterly by **Reports**, reflects the economic conditions in each state relative to the U.S. average. It consists of the most recent annual rates of change in personal income, employment, and population of each state compared to the national average of those measures. A state with a growth rate 1% over the national average in each measure would appear in the Index as a +1.0. The national average is 0.0.

Table 1: Index Of State Economic Momentum, March 1991

Rank	State	Index	Rank	State	Index	Rank	State	Index
1	Nevada	5.78	18	Maryland	0.31	34	Connecticut	-0.80
2	South Carolina	3.83	19	Arkansas	0.27	35	Pennsylvania	-0.85
3	Utah	2.19	20	North Carolina	0.15	36	New York	-0.85
4	Washington	2.18	21	Ohio	0.14	37	Tennessee	-0.90
5	Arizona	1.82	22	Kentucky	0.09	38	Missouri	-0.92
6	Idaho	1.59	23	Georgia	0.04	39	Michigan	-1.00
7	Florida	1.46		**United States**	**0.00**	40	New Jersey	-1.13
8	Oregon	1.32	24	South Dakota	-0.01	41	Delaware	-1.14
9	Alaska	1.27	25	Kansas	-0.09	42	West Virginia	-1.14
10	Hawaii	1.14	26	Alabama	-0.29	43	Illinois	-1.15
11	California	1.13	27	New Mexico	-0.29	44	North Dakota	-1.32
12	Texas	0.77	28	Montana	-0.33	45	Wyoming	-1.38
13	Colorado	0.56	29	Iowa	-0.43	46	Rhode Island	-1.86
14	Minnesota	0.46	30	Indiana	-0.48	47	Maine	-2.12
15	Wisconsin	0.38	31	Oklahoma	-0.61	48	Massachusetts	-2.41
16	Nebraska	0.35	32	Mississippi	-0.76	49	Vermont	-2.48
17	Virginia	0.33	33	Louisiana	-0.76	50	New Hampshire	-2.77

Growth Patterns: Many economists believe that there is a tendency for a state's growth rate to move toward the national average over time. This argument is particularly valid at the high end. If a state continued to grow in population, employment and income long enough, it would become the nation and hence the national average. In this quarter, there is much wider divergence from the average than in the past. There are 23 states which deviate more than 1% from the national average, and 8 states which are more than 2% off. This is up from only 15 states last quarter, 6 of which were more than 2% off average.

Western states occupy the top 11 ranks with two exceptions. Florida continues to attract new residents which contributes to the state's ranking itself and stimulates personal income and employment. South Carolina's economy has benefited from the reconstruction efforts following Hurricane Hugo, so there has been strong growth in employment and personal income from hurricane-depressed levels, making its Index second only to Nevada's.

The bottom ranks are held by New England states, where unemployment has been rising and personal income lagging. Many other Northeastern states are in the bottom third in economic momentum which accounts for the poor performance of state revenues in the Northeast.

Employment Change: Nationally, employment in the past year grew by 0.5% about half as fast as typical annual population growth. Fourteen states experienced job losses, including some Southeastern states as well as Northeastern ones. The changes are shown on Table 2.

Table 2: Percentage Change In Employment, December 1989 And 1990

Rank	State	Change	Rank	State	Change	Rank	State	Change
1	Nevada	5.86%	18	Texas	1.70%	34	Mississippi	0.44%
2	Utah	4.74	19	Ohio	1.58	35	Missouri	0.22
3	Idaho	3.55	20	Montana	1.19	36	Pennsylvania	0.00
4	Washington	3.26	21	Louisiana	1.18	37	Georgia	-0.01
5	Arizona	2.81	22	Wisconsin	1.10	38	Delaware	-0.09
6	North Dakota	2.75	23	Alabama	1.07	39	Maryland	-0.11
7	Alaska	2.67	24	West Virginia	1.05	40	Tennessee	-0.34
8	South Dakota	2.67	25	Indiana	0.96	41	North Carolina	-0.37
9	Colorado	2.63	26	Iowa	0.93	42	Michigan	-0.90
10	Nebraska	2.58	27	Oklahoma	0.91	43	New Jersey	-1.08
11	Arkansas	2.52	28	California	0.90	44	Connecticut	-1.16
12	Oregon	2.43	29	Minnesota	0.90	45	New York	-1.51
13	South Carolina	2.35	30	Wyoming	0.88	46	Rhode Island	-2.59
14	Hawaii	2.32	31	New Mexico	0.72	47	New Hampshire	-3.14
15	Kansas	2.02	32	Illinois	0.57	48	Vermont	-3.60
16	Kentucky	1.90	33	Virginia	0.54	49	Massachusetts	-4.42
17	Florida	1.84		**United States**	**0.53**	50	Maine	-4.50

The big winners in employment were in the West. Fifteen states showed an increase in employment of more than 2% between December 1989 and December 1990, with Nevada continuing to report the largest gain (5.9%) and Utah the only other state with an increase in excess of 4%. Idaho, Washington, Arizona, and Colorado all showed employment gains of more than 2.6%.

Other Indicators: Reflecting the patterns shown in the Index, retail sales in the Northeast were down in November by 0.6% from a year earlier, while the U.S. average was up 3.9% and the West and Midwest were up 5.1% and 6.2% respectively. The Conference Board's Help Wanted Index indicates that the Pacific region is suffering an employment slowdown. According to a Conference Board economist "Declines in the Pacific region have increased to the point where they now match those in the hard pressed Northeast." Many economic indicators -- the unemployment rate, housing starts, and state revenues, for example -- show that the nation's slump has reached the California economy.

INDUSTRIAL DEVELOPMENT COMPETITION

Economic Development Scorecard: Site Selection (February) has just published its compilation of announcements of new industrial facilities and expansions in 1990. The information presents many different comparative measures (see Technical Notes). **Reports** likes new plant announcements as the single most useful indicator of how the states are doing in economic competition.

In terms of state shares of the total of 1,583 manufacturing facilities announced in 1990, Texas is the winner with 146 facilities. Runners-up are Florida (103) and North Carolina (102). But the position of these large states drops considerably when the new plants are related to population as is done in Table 3.

Table 3: New Manufacturing Plants Per Million Population, 1990

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Mississippi	35.2	18	Wisconsin	7.1	34	Minnesota	3.2
2	Kentucky	16.0	19	Oregon	7.0	35	Pennsylvania	2.7
3	North Carolina	15.3	20	Nebraska	6.9	36	Maryland	2.3
4	Alabama	15.0	21	Iowa	6.8	37	Wyoming	2.2
5	South Carolina	14.3	22	Ohio	6.8	38	Rhode Island	2.0
6	Oklahoma	14.2		**United States**	**6.4**	39	California	2.0
7	Georgia	13.7	23	New Hampshire	6.3	40	Colorado	1.8
8	Tennessee	13.3	24	Arizona	6.0	41	Alaska	1.8
9	Virginia	10.9	25	South Dakota	5.7	42	Hawaii	1.8
10	West Virginia	10.0	26	Illinois	5.7	43	Vermont	1.8
11	New Mexico	9.9	27	Louisiana	5.7	44	Maine	1.6
12	Missouri	9.3	28	Indiana	4.9	45	New Jersey	1.4
13	Arkansas	9.3	29	Utah	4.6	46	New York	1.2
14	Washington	9.0	30	Michigan	4.2	47	Massachusetts	1.2
15	Texas	8.6	31	Idaho	4.0	48	Connecticut	0.6
16	Florida	7.9	32	Montana	3.7	49	Delaware	0
17	Kansas	7.6	33	Nevada	3.3	50	North Dakota	0

The outcome shown by the table is striking. Southeastern states cop eight of the top ten positions with Oklahoma and West Virginia, which share some Southeastern characteristics, getting the remaining two positions. The Northeast and California occupy most of the bottom ranks.

Economic Development and Taxes: The rush to make tax concessions to lure economic development continues with the Kentucky governor's signature of a cap on jet fuel taxes to benefit Delta Airlines if it expands operations at the Cincinnati Airport, which is in Kentucky. State and local governments continue offering concessions to attract a United Airlines maintenance facility. A bill to exempt aircraft parts from the sales tax has passed the Colorado legislature.

The Colorado legislature is also moving a bill that would extend favorable tax treatment of coal mining. In the North Dakota legislature, several measures have passed the Senate to reduce the oil extraction (severance) tax. The House has passed legislation which would eliminate the tax for incremental increases in production, defined as all production through secondary and tertiary recovery methods such as injecting wells with water. Wyoming's legislature adopted a special 2% severance rate, one third the regular rate, for wildcat wells (ones in new fields) by overriding a veto of the governor. Use of tertiary recovery would cut the severance tax from 3.75% to under 2% under a measure moving in the New Mexico House.

Oklahoma's legislature appears likely to pass legislation giving a sales tax exemption on construction materials to firms creating 100 or more jobs -- extending a concession previously granted for Kimberly-Clark to other firms.

South Dakota has acted to alter its taxes on banks with net income over $500 million. The state doesn't have banks of that size in abundance, so the measure is understood to be designed solely as an incentive for Citicorp. The old law provides a tax of 6% of income. Under the new law, income under $500 million is taxed at the old rate, but income above $500 million is taxed at rates decreasing to 1% for income exceeding $600 million.

Governor Weicker is selling his proposed new income tax as a good deal for business. "This is Christmas as far as the business community is concerned." He stresses the rollback of the corporate income tax and promised that when the deficit problem is solved he will seek to drop the rate further. He defends using a 6% flat rate rather than a graduated rate to tax personal income and reducing the tax on dividends and interest on the basis of keeping higher income persons, now "leaving in droves," in the state.

Industrial Development Exemptions And The Environment: Over thirty years ago, Mississippi began granting limited-term property tax exemptions for new manufacturing plants. The incentive was gradually copied throughout the nation. In the South, the exemptions, such as forgiveness of all property taxes on new facilities for ten years, are typically granted through state laws and state certifications. In the North, local governments generally have a greater role in the process. The exemptions make manufacturing operations cheaper but deprive local taxing jurisdictions of revenue. Because the exemptions, and their economic equivalents in other property tax concessions, are so widespread, there is no empirical way to show how important they may be in attracting development. {Comparing development in states with exemptions to development in states without is impossible if there aren't significant numbers of states without.} Those engaged in economic development believe that not having such exemptions would make their states non-competitive in drawing new investments.

The exemptions and their newer counterparts, like exemptions in enterprise zones, have their critics. There have been attempts to limit them in various ways: (1) requiring that new jobs be associated with the new investment, (2) limiting the exemption in amount and/or time for which it is available, and/or (3) limiting the taxes affected, such as providing the exemption for municipal and county taxes but not for school taxes. Louisiana is implementing a policy that seeks to tie the amount of the second five years of a ten-year exemption to avoiding pollution, with higher polluting companies granted smaller exemptions. Some Louisiana business interests are critical of the change on the theory that it will retard economic development.

Financing Transportation: Many states are involved in the financing of freight railroads to deal with the threatened abandonment of branch lines. There are also some state subsidies of inter-city passenger rail. South Dakota, with its small population and large land area, has recently been subsidizing air passenger operations through the South Dakota Airline Authority. But, so far, use of routes to six cities (two others have been dropped) has been about a third of estimates. State officials are considering dropping the idea.

STATE AND LOCAL GOVERNMENTS

Dramatic Shift Underway: Although statistics aren't easily developed, a clear shift is occurring in the relationships among the federal government, the states, and general purpose local governments -- counties, townships, cities, towns, and boroughs. {As shorthand, this article refers to all these as "cities and counties."} The shift isn't affecting how states and the federal government relate to school districts and is uneven in its impact on special districts used for water supply, sewage, transit, and other functions. The emphasis is illustrated by Governor Cuomo's budget recommendations. They suggested cutting unrestricted aid in half while protecting school aid -- in relative terms -- with a 10% reduction.

The New York budget illustrates the tendency of budget recommendations in fiscally pressed states to single out local aid for cuts. In his budget message, Governor Cuomo dealt with a $6 billion budget gap, with $1.5 billion to be handled by tax and fee increases -- again deferring a scheduled personal income tax cut, university tuition and one time adjustments. This left a $4.5 billion gap to be handled by spending cuts from current service levels. The proposed cuts are shown on Table 4.

While the allocation of New York cuts isn't strikingly dissimilar from the allocation of the base budget, Table 4 shows the large percentage of state budget cuts falling on local government. Identifiable regular local aid accounts for 43% of the cuts -- not including Medicaid which also goes to local government in New York and the portion of other programs benefiting local governments.

Table 4: Governor's Plan To Cut New York FY 1992 Spending ($ mil.)

CATEGORY/Activity	Amount	Percent
State Operations	$965	21.8%
School Aid	891	20.2
Medicaid	875	19.8
Local Aid -- Unrestricted	468	10.6
Local Aid -- Restricted	530	12.0
Higher Education	128	2.9
Other Educatiion (e.g., libraries, private colleges)	229	5.2
Social Services	175	4.0
Other	159	3.6
TOTAL	$4,420	100.0%

The essence of the shift is to leave cities and counties much more dependent on their own resources with less federal aid, less state aid in relation to total spending, and, in some but not all cases fewer mandates and more authority to raise money locally.

Measuring Local Aid: Total state aid to local government in FY 1989 was $153 billion. This represents an increase of 8% over FY 1988, slightly above the 7.6% increase in state spending. State aid represents about 43% of all state spending, but the percentage varies substantially from state to state as shown on Table 5.

Table 5: State Aid As Percentage of State Spending, FY 1989

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	California	71.1%	17	New Jersey	38.8%	34	North Dakota	28.2%
2	New York	59.4	18	Georgia	38.6	35	Maryland	27.8
3	North Carolina	54.3	19	Missouri	37.1	36	South Carolina	27.1
4	New Mexico	53.6	20	Pennsylvania	37.0	37	Iowa	26.4
5	Ohio	53.1	21	Wyoming	36.9	38	Connecticut	26.2
6	Arizona	52.5	22	West Virginia	36.8	39	Oklahoma	25.0
7	Indiana	50.1	23	Kansas	36.0	40	Alaska	24.4
8	Idaho	49.0	24	Washington	35.5	41	Massachusetts	23.9
9	Minnesota	47.1	2[illegible]	Maine	35.4	42	Rhode Island	2[illegible]
10	Florida	46.4	26	Tennessee	35.0	43	Oregon	22.1
11	Michigan	43.3	27	Colorado	32.8	44	Montana	21.1
12	Mississippi	43.1	28	Illinois	31.6	45	Delaware	19.8
13	Wisconsin	42.9	29	Kentucky	28.9	46	Nebraska	16.6
	United States	**42.9**	30	Vermont	28.7	47	New Hampshire	16.1
14	Alabama	42.6	31	Virginia	28.7	48	South Dakota	11.7
15	Utah	41.3	32	Arkansas	28.5	49	Hawaii	1.3
16	Texas	40.4	33	Louisiana	28.3		Nevada	n/a

The primary factor in determining the rankings on Table 5 is the division of functions between state and local governments. California and New York provide aid to counties for welfare -- aid that isn't provided in most other states because the state itself administers welfare. Conversely, Hawaii ranks last because it runs the schools. So it doesn't have a state school aid program.

Types Of Aid: While state aid of over $600 per capita provides massive support for local governments on average, the support for cities and counties is much less significant. Table 6 breaks FY 1989 aid into its components.

Table 6: Composition Of State Aid To Local Government

Type Of Aid	Amount (bil.)		Pct Growth FY 1989
Restricted		$136.7	8.2%
Education	$97.6		8.4
Human Services	26.9		7.8
Transportation	6.0		8.5
Criminal Justice	1.8		19.9
Environment/Natural Resources	1.0		2.1
Community & Econ. Development	0.6		-17.3
Other Restricted	2.8		10.1
Unrestricted		16.6	6.3
Total		153.3	8.0

Some 64% of all state aid is earmarked for education. Another 18% is earmarked for human services, a mixed blessing for local government because local cost sharing of rising costs, such as New York's Medicaid program, is a price of the aid. Human service grants to local government is highly concentrated. Seventeen states don't provide such aid and 79% of all aid for the function is concentrated in California, New York, and Ohio. Adding all these, 82% of all state aid is of little value in financing core functions of cities and counties, that is, functions those jurisdictions perform in most states. Furthermore, the last column shows that the earmarked functional aid is growing faster than unearmarked aid.

Aid that isn't restricted by function consists primarily of large programs in a few states rather than widespread smaller programs in many states. For example, states distribute $3,243 million as payments in lieu of taxes of which $1,909 million is by California and $665 million by Illinois.

Cutting Local Aid: In Massachusetts, a portion of the continuing state fiscal problems is being shifted to local government. The voters approved an initiative in November designed to ensure that the local share of state revenues remains constant. But the legislature may override it to avoid a state tax increase. The governor's new budget calls for a cut of about $270 million in local aid. The legislature is adopting measures that will make it easier for local governments to raise money including taxing auto sales and a liberalization of the limits of Proposition 2 1/2, the property tax limit. The governor has proposed eliminating mandates in fields ranging from special education to construction management.

To conserve cash, states have been routinely delaying payments to local governments in many instances. New Jersey did this in FY 1989. Legislation is being considered to delay again in FY 1990. The state collects business personal property taxes for local governments. The legislation would let the state hold the money, $40 million, by shifting payment to local government from this spring to July.

The Impact On Local Governments: The National League of Cities recently released a consultant's economic report for its board which commented:

> Changes in the intergovernmental system are increasing the fiscal squeeze on cities and towns throughout the United States. Federal cutbacks, current budget shortfalls in many states, and escalating mandated costs are increasing the fiscal burdens of cities and towns, even as many attempt to cope with the costs of economic and demographic change.

Facing such problems, cities and counties are looking for money and for relief from state and federal mandates increasing local costs. Their money interests include state and federal aid, metropolitan area financing, and increases in local option taxing authority by state legislation.

Meanwhile state and city-county problems are playing out in some major situations, including county finance in California (see below), financing Philadelphia, and financing New York City. New York City's fiscal situation would be serious even if the state maintained aid at current service levels. But the governor's budget cuts aid by $400 million (according to the governor) or $600 million (according to the mayor) -- or roughly $60-90 per city resident. {It is generally agreed that the budget is tougher on other communities than New York with, for example, 20% cuts for school aid on Long Island and 2% in New York.} State officials are reluctant to do much more for the city which has recently granted 5% pay increases while the state is providing employees 0%.

Realignments Of State And Local Functions: Most of the activity in state-local fiscal relations this year consists of state-initiated reductions in traditional patterns of local aid. The trend toward state takeover of certain local functions -- general assistance, other welfare and social services, and courts -- has been a victim of fiscal problems. Exceptions arise primarily in the context of increasing revenues. New Jersey's action last year involved takeovers of court and welfare costs, one of the aspects of the plan that made it particularly beneficial to low-income urban communities like Camden and Newark. In California, the governor's budget proposes shifting nearly $1 billion in state costs for community mental health and public health to the counties. The offsetting revenue would come from altering the base of the motor vehicle tax (2% of market value) and from increasing alcoholic beverage taxes and giving the bulk of the new money to counties. As with federal proposals for "sorting out" federal and state functions, the proposal raises concerns about whether the new revenues will flow to particular counties in proportion to the increased spending responsibility and whether, as the Legislative Analyst suggests, the growth in spending is likely to be faster than the growth in revenues.

Limited Good News For Local Government: Not all the news from state capitols is bad news for local government finances. The proposals for broadening the base of state sales taxes, such as those in California, typically broaden the base of local option sales taxes automatically, and thus increase local tax revenues without local legislative action. Second, in limited instances, cuts in state programs cut local costs as well, with the Medicaid proposals in New York (e.g., some copayment by patients) the most prominent example. Third, officials of some states, such as Massachusetts and New York, are working to find ways to reduce state-mandated costs for cities and counties. In the name of education restructuring, officials of many states are trying to do the same thing for school districts.

Providing local governments with more revenue options is also popular. In Massachusetts, the door is being opened to property tax increases without some of the difficulties previously imposed by Proposition 2 1/2. In California, the governor has proposed a new half-cent county sales tax for law enforcement and moving from two-thirds to majority approval for school and jail bonds.

TRAVEL AND TOURISM

William Pound, the National Conference of State Legislatures executive director, says "an aggressive and creative approach to travel and tourism can pay big dividends to the states." To tap this potential, NCSL has just published Travel and Tourism: A Legislator's Guide. The 116-page volume asserts that travelers' spending accounts for 6.7% of gross national product, is the source of nearly six million jobs, and makes travel and tourism the third largest retail industry, outranked only by food stores and auto dealers.

States have quite different success in attracting the high-spending international tourist. Table 7, derived from a table in the NCSL study, relates the number of foreign tourists to state populations.

Table 7: Overseas Visitors Per Hundred Residents, 1990
(excludes visitors from Canada and Mexico)

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Hawaii	223.0	17	New Hampshire	6.6	34	Michigan	2.9
2	Nevada	83.5	18	Connecticut	6.5	35	Idaho	2.9
3	Wyoming	31.4	19	New Jersey	6.5	36	South Carolina	2.8
4	Florida	25.9	20	Delaware	6.0	37	North Carolina	2.8
5	Arizona	23.7	21	Alaska	6.0	38	Ohio	2.6
6	New York	21.5	22	New Mexico	5.8	39	Wisconsin	2.5
7	Utah	18.6	23	Maine	5.7	40	Iowa	2.4
8	California	15.4	24	Georgia	4.5	41	Indiana	2.2
9	Massachusetts	13.6	25	Pennsylvania	4.2	42	Alabama	2.2
10	Colorado	10.4	26	Oregon	4.1	43	Kentucky	1.9
11	Louisiana	10.3	27	Texas	4.0	44	Nebraska	1.8
	United States	**10.0**	28	Tennessee	4.0	45	Kansas	1.7
12	Rhode Island	9.1	29	Minnesota	3.8	46	Oklahoma	1.6
13	Washington	8.1	30	Virginia	3.8	47	Arkansas	1.3
14	Illinois	7.8	31	Maryland	3.8	48	Mississippi	1.0
15	Vermont	6.9	32	Missouri	3.4		North Dakota	*
16	South Dakota	6.8	33	Montana	3.4		West Virginia	*

* Not Enough To Make The Count Reliable

The table suggests that the economic benefits of international tourism are highly concentrated in a few states. These are Hawaii, a popular beach destination for Japanese as well as Americans, gambling in Nevada, New York City, and some of the major national parks and theme park locations. Most states are well below the national average. Mexican and Canadian tourists (not shown in the table) concentrate their trips in neighboring states like Texas, Maine, and Michigan.

The report provides examples of state targeting of overseas tourists, such as marketing to British and German tourists by South Carolina. A few states have substantial budgets to promote foreign tourism, particularly Florida, Hawaii, and Illinois. Each spent over a million dollars for this purpose in FY 1989. This doesn't include the many state outlays for highways, historical sites, and state parks. Most state outlays for travel promotion are oriented to domestic tourism or, as with brochures, have no particular geographic orientation. Travel office budgets for the 50 states were $341 million in FY 1990. The biggest spender is Hawaii ($22.5 million) followed by larger states like New York, Illinois, Texas, and Pennsylvania. California is an exception. The largest state in population had the

20th largest travel budget. Travel budgets per capita are shown on Table 8.

Table 8: Travel Office Budgets Per Capita, FY 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$20.62	18	Illinois	$1.92	34	New York	$1.22
2	Hawaii	20.20	19	New Hampshire	1.90	35	Louisiana	1.22
3	Wyoming	8.57	20	Minnesota	1.84	36	Missouri	1.18
4	Montana	5.65	21	New Mexico	1.79	37	Massachusetts	1.16
5	South Dakota	4.57	22	Wisconsin	1.73	38	Texas	1.11
6	Nevada	4.24	23	Maine	1.69	39	Oregon	1.07
7	Vermont	3.55	24	Virginia	1.66	40	New Jersey	1.03
8	Arkansas	3.26	25	Iowa	1.60	41	North Carolina	0.96
9	Rhode Island	2.80	26	Arizona	1.51	42	Nebraska	0.94
10	South Carolina	2.47	27	Michigan	1.51	43	Mississippi	0.88
11	North Dakota	2.42	28	West Virginia	1.50	44	Kansas	0.86
12	Colorado	2.37	29	Maryland	1.38	45	Florida	0.73
13	Idaho	2.29		**United States**	**1.37**	46	Connecticut	0.60
14	Tennessee	2.17	30	Kentucky	1.37	47	Washington	0.55
15	Utah	2.14	31	Pennsylvania	1.33	48	Indiana	0.54
16	Delaware	2.10	32	Georgia	1.27	49	Ohio	0.49
17	Oklahoma	2.00	33	Alabama	1.26	50	California	0.22

In relation to population, the smaller states are some of the most aggressive promoters of tourism. California and Florida are in the bottom ten states in per capita travel spending.

The report concludes that the primary role tourism offices see for legislatures is providing money. It includes comparative tables on state taxes earmarked for tourism development. But there are also recommendations for legislators on other topics, such as making sure travel efforts are coordinated with economic development and carried out pursuant to a plan.

FEDERAL-STATE RELATIONS

Federal Tax Burdens: The Tax Foundation (470 L'Enfant Plaza, S.W., Washington, DC 20024) has released its FY 1991 estimates of the per capita burdens of federal taxes, shown on Table 9.

Table 9: Estimated Per Capita Burden Of Federal Taxes, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Connecticut	$6,801	18	Minnesota	$4,265	34	North Carolina	$3,503
2	New Jersey	6,314		**United States**	**4,235**	35	Tennessee	3,464
3	Massachusetts	5,487	19	Florida	4,177	36	Arizona	3,446
4	Alaska	5,442	20	Ohio	4,008	37	Oklahoma	3,236
5	New York	5,285	21	Colorado	3,985	38	North Dakota	3,221
6	Maryland	5,116	22	Wisconsin	3,972	39	Montana	3,221
7	Delaware	5,085	23	Vermont	3,906	40	Kentucky	3,099
8	New Hampshire	4,921	24	Kansas	3,895	41	South Dakota	3,078
9	Illinois	4,816	25	Missouri	3,850	42	Alabama	3,066
10	Nevada	4,709	26	Oregon	3,800	43	Idaho	3,010
11	California	4,670	27	Indiana	3,724	44	South Carolina	2,994
12	Rhode Island	4,576	28	Texas	3,697	45	Louisiana	2,970
13	Virginia	4,387	29	Nebraska	3,669	46	Arkansas	2,924
14	Michigan	4,356	30	Georgia	3,669	47	New Mexico	2,915
15	Hawaii	4,304	31	Iowa	3,646	48	Utah	2,800
16	Pennsylvania	4,294	32	Maine	3,646	49	West Virginia	2,782
17	Washington	4,265	33	Wyoming	3,623	50	Mississippi	2,456

The size of the numbers is the most noticeable feature of the calculation, with the average family of three paying nearly $13,000 in federal taxes. The burden continues to grow, with the Foundation estimating the per capita burden will rise 6% to nearly $4,500 in FY 1992. Because the primary federal tax base is personal income, the distribution among states closely mirrors per capita income comparisons. Because statistics are available by state on federal spending by category, it is possible to calculate "terms of trade" with the federal government. For example, statistics showing major gainers (e.g., New York) and losers (e.g., California) from federal grants and the taxes that pay for them appear in States In Profile (Table F-2).

Federal Grant Increases: It has become increasingly difficult to blame the federal government for spending cutbacks that have caused fiscal problems for state government. Federal aid has been growing faster than inflation for some years. In the President's FY 1992 budget, grants to state and local government are slated to increase by 7.8%, well above the percentage increase likely in what state and local governments raise from their own taxpayers. Former NCSL fiscal expert Steven Gold recently gave a speech titled: "Is The Federal Government Responsible For State Fiscal Problems?" He concluded:

> The major sources of state fiscal problems are the rapid growth in spending on Medicaid, prisons, and elementary-secondary education, accompanied by inadequate growth of revenue. The federal government is partly responsible for state fiscal problems because Medicaid is a federal program, because it has allowed the recession to

occur, and because of its tax policy and aid reductions. But the federal government is not primarily responsible for growth in prison or school spending, and the inadequacies of state tax systems would be causing revenue problems even if there were no recession. The federal government can be blamed for many problems, but the sad state of state finances is not one of them.

From the perspective of cities and counties, the picture is different. The major growth in federal aid has been in programs directed to states, like Medicaid, while the major attempted reductions have been in programs directed at local government, such as community and economic development. The trend is likely to continue as shown on Table 10.

Table 10: Proposed FY 1992 Grant Outlays In President's Budget

Program/Category	Amount ($ billion) FY 1991	FY 1992	Increase Over FY 1991
Medicaid	$51.6	$59.8	16.1%
Education and Social Services	26.8	27.6	3.0
Family Support (AFDC)	14.1	15.1	7.1
Subsidized Housing	10.3	11.6	13.5
Subtotal, Four Grant Categories	102.8	114.2	11.2
All Other Grant Programs	55.8	56.7	1.6
Total, All Programs	158.6	171.0	7.8

The table shows essentially all the growth in federal aid in a few programs. Two of the most rapid growing ones, Medicaid and AFDC, don't mean fiscal relief -- they simply reflect federal costs growing in lockstep with rising state costs. One, subsidized housing, primarily reflects commitments under old housing subsidy contracts. Finally, most cities and counties don't benefit substantially from the education and social services category. So while grant totals grow, city and county officials complain that federal aid is being reduced.

Federal Preemption And Mandates: Proposals for federal preemption of state laws continue to appear with regularity in the Congress. In health care, there is another substantial crop of proposed Medicaid mandates. Also, the administration's budget reflects the setting aside of a special fund of nearly $1 billion associated with hospital reimbursements in Medicare and Medicaid. The winners would be hospitals in states that enact stipulated tort reforms, such as limits on non-economic damages in medical malpractice actions and elimination of joint and several liability. Losers would be hospitals (and thus patients and those paying their bills) in states that don't enact the legislation. Some states are already losing highway safety money because they haven't complied with all the federal requirements for state law changes affecting driving under the influence.

California has decided it would rather fight than switch in response to the new federal nursing home guidelines. The decision to reject the standards was reflected in state legislative action last year and was affirmed by Governor Wilson who has written the President that the federal government was "improperly attempting to mandate standards on the states." State officials claim that the new requirements would cost about $500 million a year, of which half would be state funds. California's problems are presumably shared in other states, with several other states said not to be in compliance either.

The federal remedy is to cut Medicaid funding, which federal officials are apparently reluctant to do. To date, they have announced withholding about $24 billion out of about $5 billion for the federal contribution to the California program. Federal officials recently announced that over 100 of the about 140 federal nursing home inspectors will be sent into the state.

There is litigation over the dispute in several courts. Compromise negotiations produced a mid-March preliminary agreement which defers action on the litigation, triggers more discussion on guidelines, and meanwhile treats guidelines as "tools" for inspectors rather than requirements.

MISCELLANY

Indian Reservations: For those states affected, the recent unanimous U.S. Supreme Court decision in Oklahoma Tax Commission v. Potawatomi Indian Tribe is an important affirmation of state government's ability to tax and to protect taxpaying merchants against other merchants paying no tax. The conclusion, reversing a lower federal court, is that Oklahoma can apply its cigarette tax to sales to non-Indians made on reservation land.

Litigation And State Finances: The latest U.S. Supreme Court opinion affecting state finances represents another potential cost to states, though it will have no immediate effect. The immediate issue is whether a Reconstruction Era civil rights statute, which already is now applied to such issues as suits against law enforcement agencies, can be used by an Ohio trucker in a tax dispute with Nebraska -- in addition to the other remedies available. By a 7-2 decision in Dennis v. Higgins, the court sided with the trucker.

TECHNICAL NOTES

Fiscal Situation: For extensive discussion of a "structural deficit" in California, see Legislative Analyst (925 L St., Sacramento, CA 95814), The 1991-92 Budget: Perspectives And Issues and California Taxpayers' Association (921 11th St., Sacramento, CA 95814), California's Budget Dilemma: Cyclical And Structural Problems in the organization's Cal-Tax News.

Economic Development: The state-by-state figures from Site Selection also cover the 1988-1990 period, which the magazine prefers for its comparisons. In addition to the new manufacturing facilities there are also statistics on expansions and on non-manufacturing facilities such as distribution centers for retailers and new communications facilities. By including new facilities outside manufacturing, somewhat different results can be produced. Those facilities, such as communications centers and warehouses, tend to be located in population centers.

The Louisiana dispute over considering environmental impacts in renewing tax exemptions is assessed in detail in the New York Times (2/27).

State And Local Governments: In New England and a few other situations (e.g., Maryland, New York City, Virginia), the general purpose local governments are responsible for the financing of schools. While these states separate school aid from unrestricted aid, the purchasing power is essentially fungible in practice. This makes trends to increase state school aid and decrease aid to cities and counties contradictory in those states. Because of the adverse fiscal circumstances, these states have been resolving the contradiction by cutting their support of local budgets.

State aid to local governments is measured by the Census Bureau and by a new publication of the National Association of State Budget Officers (444 North Capitol St., NW, Washington, DC 20001), State Aid To Local Government, 1990 which is the basis of the statistics in the article. NASBO, unlike the Census Bureau, excludes federal money passed through states to local government. The California proposal is assessed in 29-page section of the California Legislative Analyst's The 1991-92 Budget: Perspectives And Issues.

Federal Impacts: Gold is Director, Center for the Study of the States, State University of New York at Albany. His February 6 speech was to a local chapter of the American Society for Public Administration. The federal aid calculations were developed from Federal Funds Information for States' Special Analysis: Budget Of The United States Government: FY 1992.

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April 1991 (First of Two April Issues)

SCHOOL SPENDING AND AUSTERITY

Introduction: Fiscal problems have shifted the education quality emphasis in most states away from expensive measures like smaller class sizes and higher teacher pay. As John Brandl (U. of Minnesota) suggested at the National Conference of State Legislatures' fiscal chairs seminar in January, legislators are looking hard at better ways to use existing resources. One example is the emphasis on toning down state mandates and the roles of state education departments in order to give school districts more autonomy. This theme is being particularly pressed in New Jersey, Virginia, and Wisconsin. There are also many special programs oriented toward the six education goals developed by the governors and the President.

High Impact Education Quality Initiatives: The 1980s saw many examples of what might be called the prototypical state education quality plan. The concept was pioneered in Southern states like Mississippi and South Carolina. It typically involved: (1) a state tax increase to improve education, (2) substantial increases in teacher pay, (3) relatively expensive measures like expanding the school year, increasing the number of students in pre-school, and/or reducing class sizes, (4) management measures such as merit pay or career ladders and training of teachers and administrators, and (5) accountability measures such as teacher and student testing and published measures of comparative performance of schools or school districts.

The concept of these plans isn't dead. Major educational quality programs of this type, complete with large state tax increases, were enacted in Kentucky and Oklahoma in 1990, along with a smaller one directly associated with teacher salary increases in West Virginia. Mississippi adopted such a measure, but legislators and the governor couldn't agree on a funding source. This year, such an increase was adopted in Arkansas with funding from an increased sales tax. A separate plan for vocational education is pending with funding from a corporate income tax hike. There is considerable interest in such a plan in Missouri. In some of the states with thriving economies, such as Idaho and Washington, there have been substantial funding increases and various new quality measures without the necessity for tax increases.

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The most comprehensive of the plans this year is under discussion in Tennessee. Its education component was painstakingly developed through widespread consultation with just about everyone in the state with an interest in education. Its financing would come from adopting an income tax to replace the state's current tax on unearned income (e.g., dividends) but not wages and salaries. The revenues would both finance education improvements and lower existing sales taxes.

Education Financing Initiatives: Much of the interest in education spending this year is heavily oriented to financing matters, not directly on what goes on in the schools. The financing plans often include educational quality components. But their primary motivation relates to: (1) the allocation of money among districts, (2) which taxes are used to pay to education, or (3) both. One example is the increase in the state sales tax and new school aid distribution formula developed in Texas last year to deal with a supreme court decision on school finance equalization. Another is last year's tax increases in New Jersey which financed massive revision of the school aid formula, also to deal with a state supreme court decision on equalization. Both are covered in the equalization article in this issue.

Despite fiscal pressures, these types of financing issues are major components of educational policymaking in many states this year. In Oregon, the subject has been forced on legislators by a voter decision last year to restrict the level of property taxes available for schools. In New Jersey, legislators revised last year's program to take money from school aid, still leaving over a 20% increase, to increase property tax relief, and to reduce mandates for some school districts to increase property taxes. In states with major spending cut proposals on the table, like Massachusetts and Pennsylvania, there are also major school finance issues. They involve both the local authority to tax and how the available state money is divided among districts.

Austerity, School Funding, and School Quality: The austere budget environment of most states has had an understandably chilling effect on new state educational quality initiatives. State officials are reluctant to impose new cost-increasing mandates on local districts without funding the mandates or providing inflation-beating adjustments in overall school aid. Both school administrators and teachers tend to urge funding what already exists as a priority over new initiatives.

Austerity can also make casualties out of previously adopted plans. In fiscally pressed North Carolina, the governor has proposed skipping the scheduled $84 million increase in funding for FY 1992 associated with the education reform program. Georgia continues to have difficulty in funding its Quality Basic Education program. In other states, tight budgets provide an opportunity for teachers and administrators to renew their objections to some of the educational quality items they opposed when they were adopted.

Some of the earlier education reform plans may become casualties of three separate trends. Those plans often involve demonstrations or specific concepts to be adopted statewide as a result of a state decision to improve quality, sometimes backed by special grants. In the current context, such narrow grants and a state education department staff providing guidelines and administering funds are subject to criticism. First, it involves power at the state level rather than the site-based management now popular among educational reformers. Second, it contradicts the increasingly popular rhetoric for local control. Third, it conflicts with austerity-driven notions of letting local officials do the best they can with whatever the state can afford. One result is a plan moving through the Florida legislature, "Blueprint 2000," with a major thrust to eliminate smaller categorical programs. Programs for transportation, health, and instructional categories would be folded into what, at the federal level, would be called a block grant. Mississippi is working along the lines of freeing high-performance districts from state regulation, while Virginia is downsizing its education department staff.

Education Budgets: It is much too early to tell the outcome of the deliberations on FY 1992 budgets for education in the larger states. A common pattern of the late 1980s was an education budget that, as enacted, was more generous than budgets for most other state activities. But the education priority measured this way was often overtaken by large supplemental appropriations for other functions, particularly corrections and Medicaid. This would leave education spending growth below some of those functions, and often below state spending overall. Nonetheless, the result wasn't totally unsatisfactory so long as the state education increase covered changes in pupil counts, covered inflation, and had money left over -- as it often did.

This year, in California and eastern states, the math is not permitting this result without major tax increases. The numbers differ from state to state, but show the same pattern. The FY 1992 revenue growth being projected is in the range of 3-7% (lower in the Northeast) with assumed inflation of about 5%. This 3-7% growth gets lowered a percent or two to deal with covering items financed with one-time revenues or savings in FY 1991 and with deficits carried over overtly or covertly. Out of that growth comes an increase in corrections of 8-13% and an increase in social and health service programs (principally AFDC and Medicaid) of 10% or more. In such a context, aid to local government must be below inflation. In some states (e.g., Minnesota), it is possible to concentrate cuts on non-school aid. But in most states, school aid can't match inflation without massive cuts in other state functions.

The problem is most readily apparent in California because a constitutional amendment (Proposition 98) embodies educators' expectations for: (1) a constant share of the budget devoted to education and (2) education funding reflecting inflation plus growth in the number of pupils. The governor's budget, even with its new taxes, doesn't comply with the requirement. Legislative action in compliance is difficult as well, particularly if the legislature complies with another constraint in the constitution -- the tax limit.

Teacher Salaries: As a result of these fiscal circumstances, salaries of teachers are not likely to increase as they have in the past decade -- providing inflation plus some real increase. Recognizing this, many teacher organizations are backing tax increase proposals. The statewide salary comparisons developed by the National Education Association are shown in Table 1.

Table 1: Average Teacher Salaries, FY 1990

Rank	State	Salary	Rank	State	Salary	Rank	State	Salary
1	Alaska	$43,153	17	Virginia	$30,926	34	Tennessee	$27,052
2	Connecticut	40,461	18	Oregon	30,840	35	Maine	26,881
3	New York	38,925	19	Colorado	30,758	36	Iowa	26,747
4	Maryland	36,601	20	Nevada	30,590	37	Kentucky	26,275
5	California	36,418	21	Indiana	30,493	38	Nebraska	25,522
6	Rhode Island	36,057	22	Washington	30,475	39	Alabama	25,[illegible]0
7	Michigan	36,010	23	Arizona	29,402	40	New Mexico	25,120
8	New Jersey	35,676	24	New Hampshire	28,986	41	Montana	25,081
9	Massachusetts	34,175	25	Florida	28,806	42	Mississippi	24,364
10	Delaware	33,37[illegible]	26	Vermont	28,798	43	Louisiana	24,300
11	Pennsylvania	33,338	2[illegible]	Kansas	28,671	44	Idaho	23,861
12	Illinois	32,794	28	Wyoming	28,188	45	Utah	23,735
13	Minnesota	32,190	29	Georgia	27,892	46	Oklahoma	23,070
14	Hawaii	32,047	30	North Carolina	27,814	47	North Dakota	23,016
15	Wisconsin	31,921	31	Texas	27,496	48	West Virginia	22,842
16	Ohio	31,200	32	Missouri	27,229	49	Arkansas	22,009
	United States	**31,166**	33	South Carolina	27,200	50	South Dakota	21,300

These data on average salaries are good indicators for some purposes but not others. They are a good indicator of a major factor of school costs. They are also a good indicator of the welfare of a state's teachers, to the extent that their welfare can be measured by money. They are a poor indicator of the offers that school districts are making to particular teachers. The average salary reflects the pay schedule for teachers, including the starting salary. But the average is heavily influenced by the maturity of the teaching force. A state with a large number of newly hired teachers, like California or Nevada, will tend to have lower average salaries than a state without enrollment growth and a larger percentage of teachers high on the pay scale.

Pupil-Teacher Ratios: Besides salaries, the other key variable affecting costs per pupil is the pupil-teacher ratio shown on Table 2.

Table 2: Pupils Per Teacher FY 1990

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	California	22.9	18	North Carolina	15.9	34	South Dakota	14.7
2	Utah	22.3	19	Ohio	15.9	35	Virginia	14.7
3	Washington	18.8		**United States**	**15.9**	36	Iowa	14.6
4	Michigan	18.5	20	Florida	15.8	37	North Dakota	14.5
5	Idaho	18.3	21	Georgia	15.8	38	Pennsylvania	14.4
6	Nevada	17.8	22	Indiana	15.8	39	Missouri	14.2
7	Tennessee	17.5	23	Kentucky	15.8	40	West Virginia	14.0
8	Arizona	17.3	24	Maryland	15.7	41	Wyoming	14.0
9	Mississippi	17.3	25	New Mexico	15.4	42	Nebraska	13.9
10	Alabama	17.2	26	Oklahoma	15.2	43	Maine	13.6
11	Hawaii	17.0	27	Texas	15.2	44	Kansas	13.5
12	Oregon	16.9	28	Delaware	15.0	45	Rhode Island	13.2
13	Colorado	16.2	29	Montana	14.9	46	Massachusetts	12.7
14	Louisiana	16.2	30	New Hampshire	14.9	47	Vermont	12.7
15	Arkansas	16.1	31	Wisconsin	14.9	48	Connecticut	12.5
16	Minnesota	16.1	32	Alaska	14.8	49	New Jersey	12.5
17	South Carolina	16.0	33	Illinois	14.8	50	New York	12.3

Austerity And The State Rankings: Many state officials, as well as teachers, have objectives of increasing teacher salaries (e.g., by x% or to x% of a national or regional average) and/or reducing class sizes. Such objectives are often part of education quality plans approved in the 1980s. In many states there are mandates to school districts for minimum salaries and maximum class sizes.

Several developments associated with state finances should reshuffle the rankings in Tables 1 and 2 by the time the statistics for FY 1992 are issued. Education-oriented tax increases should provide major increases for states like Arkansas, Kentucky, New Jersey, Oklahoma, and West Virginia. These actions and the comparative prosperity of some Western and farm states should cause salaries to rise faster and class sizes to drop more in states West of the Mississippi, which generally have trailed the national average in indicators of educational spending.

Some of the states with the highest teacher salaries -- like Connecticut, New York, Michigan, Rhode Island, and Massachusetts -- are suffering some of the nation's most severe fiscal problems. While final decisions haven't been made in these states, there is little likelihood of substantial new state money for schools. Cutbacks are under serious consideration, particularly in Massachusetts and New York, and Michigan is considering a proposal from the governor that would substantially curtail property tax revenues.

THE CORRECTIONS BILL

The Corrections Problem: Fiscal problems have created difficult policy choices for state officials in dealing with corrections. The propensity of the public, as indicated by polls, is to be tough on crime through longer sentences, less plea bargaining, and fewer early releases. The impact of federal officials, as indicated by mandates, is to increase the use of prison terms for dealing with drug abuse and drunken driving. The preference of many state officials is also to be tough on crime. This tends to increase sharply the number of prisoners (see Issue 1) even though crime hasn't been increasing. Litigation by civil rights groups and the federal government is leading to increases in the cost of operating prisons as states comply with court orders to improve conditions. The combination of more prisoners and higher cost per prisoner has been driving corrections costs upwards at double digit rates in many states.

In discussing the fiscal issues involved at NCSL's January fiscal chairs session, James Austin of the National Council on Crime and Delinquency suggested legislators not make major changes in state policy. He warned that an "increasingly impoverished, badly educated population means the criminal population won't be decreasing." But he indicated that newer ideas, such as boot camps and intensive parole, won't necessarily solve corrections problems.

By just about any measure, the United States has a strong tendency to hold people in prison. California alone has more prisoners, 40,000 more, than either Great Britain or Germany. The prison population grew rapidly during the 1980s, while the crime rate was about constant. Some states have nearly twice the population incarcerated as the national average (a 50-state table appears in Issue 1). Yet 70-80% of the population consistently tells pollsters that punishments for crime are not harsh enough. An indication of the growth rates involved will be seen from Table 3.

Table 3: Corrections and Related Populations (000), 1980-1988

Category	1980	1988	Percent Change
Probation	1,118	2,356	111%
Jails	164	344	110
Prison	330	628	90
Parole	220	408	85
Adult Arrests	6,100	8,500	39
Adult Population	162,800	182,600	12
Reported Index Crimes	13,400	13,900	4

Looking For Alternatives To Incarceration: Some states are considering measures that seek to stem the growth in corrections costs while not eroding the objective of making the streets safer. One of the illustrative spending cuts offered by California's Legislative Analyst is to substitute parole for prison for felons about to be transferred to state prisons from county jails. The Analyst also suggests investing in nonresidential drug treatment for parolees as a way to save future incarceration costs. But on the broader issue of community corrections, the Analyst's issue paper concludes:

> Expenditures to support the state's growing prison and parole populations continue to increase at a rapid rate. In addition, the state currently has a limited range of punishment options for many criminal offenders. One potential way to address this growing population in a more effective way is through "community corrections" programs. This approach involves the use of intermediate sanctions as an alternative to state prisons. In evaluating community corrections programs, the Legislature will have to consider the fiscal benefits, public safety issues, and treatment effectiveness of these programs.
>
> There is some evidence indicating that these programs can be more viable corrections alternatives than state prisons in certain cases. However, this evidence is limited, and there is uncertainty about the overall effectiveness of these programs, especially if applied on a large-scale basis. Consequently, the Legislature should take a cautious, evolutionary approach to the expansion of community corrections programs. Specifically, the state should promote small-scale piloting and experimentation with targeted populations, and undertake evaluations of program effectiveness.

An assessment of the boot camp programs by Doris MacKenzie (National Institute of Justice) finds 17 states now have boot camps for some adult offenders, up from 11 in 1989. Electronic monitoring use is increasing as well. There were 6,500 people in monitoring in 1989, up from under 100 in 1986.

Lowering Prison Staffing: State officials have generally avoided reducing the staffing at correctional institutions even in the midst of government-wide hiring freezes, layoffs, and furloughs. **Reports** knows of only one state, Michigan, that is applying these measures in significant ways to corrections. In Illinois, the governor has proposed delays in opening new prisons.

Sentencing Changes: There appears to be substantial interest in reducing the amount of time certain offenders spend in prison by changes in the sentences convicted offenders serve. For example, Governor Cuomo has proposed to eliminate the automatic incarceration of nonviolent second-time felons. The proposal is linked to hopes that the state can avoid construction of five new prisons.

Paying The Bill: Most state officials are paying the costs despite the pressures doing so puts on other spending. The likely increase in the California corrections budget is around 14% with bond-funded prison construction adding something like $400 million a year. The capacity expansion is associated with a projected increase in prison population from about 100,000 now to 175,000 before the end of the decade. When asked if the state could afford this spending growth, Governor Wilson commented, "Can we afford not to?"

The Texas prison system has about 50,000 beds and already has approvals for adding 15,000. The corrections agency is looking for approval of nearly 40,000 more, well in excess of the governor's budget request which calls for 12,000 over the biennium. Three factors in the increase: (1) growing state population, (2) increased drug enforcement, and (3) reclassification of more than 40 misdemeanors to felonies. Drug sentences are the cause of sharp growth in prison populations in Tennessee, according to its corrections director. The Texas situation, which includes court-ordered constraints on crowding, is producing a rapid flow of parolees -- one fifth of the nation's total.

The Idaho budget calls for a 23% increase in corrections -- though much of it is associated with alternatives to prison incarceration including a boot camp, a community work center, and increasing the parole and probation staff.

Corrections In Florida And Georgia: The difficulties in funding corrections have been particularly evident in Florida and Georgia. Both states have been reluctant to increase taxes while their officials have tried to increase state support of schools sharply. Both states have high incarceration rates. Both states have passed measures to get tough on crime by stiffer sentences for a variety of offenses -- drugs, second offenders, sex-crimes, drunken driving, etc. But prison construction didn't keep up and judicial constraints on prison crowding put a limit on how many prisoners could be put into the available space. So while accelerating movement of persons into prison, these states (and others) had to accelerate movement out by early release programs. In Florida, this means that prisoners now serve about 33% of their sentences, down from 52% four years ago.

Georgia's Governor Harris pushed prison construction in his two terms that ended early this year. His summary of accomplishments on leaving office cited with pride a doubling of prison beds during his terms with enough approved for future construction to create a prison capacity increase of 171%, accompanied by a corresponding increase in state correctional employees. His report included the projections shown in Table 4.

Table 4: Corrections Population In Georgia, 1980-1999

Category	1980	1985	1990	1995	1999
Prison	13,011	16,299	21,584	40,247	56,266
Probation	42,012	89,420	120,835	189,829	277,928
Parole	3,169	7,796	20,602	37,529	59,906

These statistics implied a continuing major drain on the Georgia budget. Yet even the pace of construction over the past eight years has not averted the need to reduce crowding through an early release program that was undertaken in 1989. In his state-of-the-state message, Governor Miller pledged to get rid of early release. He proposed adoption of a "boot camp" approach, particularly for drug offenders, citing as an example the Parris Island boot camp where he was stationed as a Marine.

SELLING ASSETS AND PRIVATIZATION

Introduction: "Privatization" continues to receive attention from those who discuss trying to make government cheaper, including many people who talk about state, as well as federal and local, policies. The lengthy debates (see Technical Notes) are easily summarized. Privatization proponents argue that the private sector can perform some government functions more cheaply and often more efficiently. Opponents contend that the economies are often false or occur only because private contractors pay inadequate wages. They contest the efficiency claims and argue that government as a matter of policy shouldn't contract out some functions, such as disciplining inmates.

In this year's state budget debates, there is some discussion of these kinds of "contracting out" issues, but no obvious trend and not much money at stake. Privatization has attracted more attention where the primary motivation is obtaining money from the sale of assets or avoiding state costs by capital financing through the private sector. The really big money decisions are in the choice between private and public providers in education, mental health, and highways. Major decisions on privatization-type issues in those fields are often considered under other rubrics such as educational choice, tuition and scholarship policy, or community versus institutional mental health.

Contracting Out: The magnitude of the contracting out decisions is illustrated by Connecticut. A $4 million study of saving money in Connecticut government concluded that privatization is an option to be considered and recommended a mechanism for reviewing possible choices. It provided a list of projects totalling $6.2 million in savings, most of which is assumed savings from contracting out for medical care. The other fields are custodial services, laundries, food service, and $250,000 in savings from relying on the private sector for "mop and mat cleaning service."

These proposals, not all of which may be adopted, reflect the relatively minor nature of many of the contracting out discussions in state government. The issues tend to revolve around services which have counterparts in the private sector, such as food service, computer programming, legal services, and debt collection. While contracting out is discussed as an economy move in some settings, shifting to public provision of services is discussed in others. Example: the continuing concern in Massachusetts over reducing the use of consultants. It has been a hot topic in the legislature and the subject of a barely unsuccessful initiative on the November ballot. There has also been controversy over the use of temporary help from a private agency rather than the use of state employees in Ohio. Last year in New York, a comptroller's report said the state could save millions by doing highway design work in-house rather than contracting it out.

These issues of contracting out operating functions at the state level are minor by comparison with parallel issues at the local level, such as contracting out the refuse collection function. The contracting out issues are also minor relative to broader issues on the financing of facilities and relative reliance on the private sector in health, education, and other fields.

The Private Sector In Corrections: In a recent report on privately run prisons, the General Accounting Office concluded, "existing empirical studies on service and cost are inconclusive." According to GAO, "the state interest in turning over existing facilities to contractors has been limited primarily to selected activities with private counterparts -- health service, food service, laundries -- rather than entire institutions, probably because of perceived problems with eliminating the jobs of current state employees."

Interest in having the private sector finance prisons has been much higher. Although it would be possible to have a company (or state authority) build a prison and lease it to the state for staffing with state employees, most interest has focused on private construction and operation. Proposals of this type are active in many states. There is also some interest in speculative construction of prisons (e.g., by Private Prisons of America in West Virginia) with capacity being sold on a per diem basis to governments needing extra space.

Privatizing Schools: There are many privatization issues in public schools involving ancillary services (e.g., school bus service, maintaining schools, food service) rather than education functions. The major example of privatizing the operation of public schools is the operation of Chelsea schools by Boston University, but it is too early to judge results. Potentially having much more effect are tuition tax credit plans (Iowa and Minnesota) and choice plans that permit government payment of tuition at private schools (Milwaukee).

Movement from the private sector to the public is illustrated by Hawaii's unique A+ program. Hawaii is the only state to have taken statewide action to deal with latchkey children, those who don't have a parent at home when the school day ends. Now the state is providing an after-school program for these children with components parallel to regular school like tutorials, physical activities, and drama. The program is free for children eligible for special priced meals and costs a maximum of $1 a day for others. One impact is to serve children who wouldn't otherwise be served. Another has been to draw children out of programs like that provided by the YMCA that must charge more to students and pay less to staff.

Private Higher Education: Public subsidy of private providers of education is much more common in higher education than elementary and secondary. Some states contract for student slots in private schools (e.g., Cornell) in specialized programs. Students pay the tuition for state universities with the state making up the difference between what the student pays and what the private institution charges. Many states, as well as the federal government, provide financial aid that students can use in private colleges and universities. The percentage of enrollment in private institutions shown on Table 5 reflects the diversity among the states.

Table 5: Percent Of Enrollment In Private Institutions, FY 1988

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Massachusetts	59.4%	18	Georgia	23.8%	34	Oklahoma	14.2%
2	Rhode Island	54.3	19	North Carolina	22.8	35	Washington	14.1
3	New York	45.1	20	Indiana	22.2	36	Texas	13.6
4	Pennsylvania	45.0		**United States**	**22.0**	37	Virginia	13.6
5	New Hampshire	43.8	21	New Jersey	21.8	38	West Virginia	11.5
6	Vermont	42.7	22	South Carolina	20.9	39	Colorado	11.1
7	Connecticut	39.7	23	Florida	19.8	40	Alabama	10.8
8	Missouri	32.3	24	Kentucky	19.5	41	Arkansas	10.3
9	Utah	32.2	25	Hawaii	19.3	42	Kansas	9.7
10	South Dakota	30.4	26	Nebraska	18.8	43	Mississippi	9.0
11	Maine	29.9	27	Delaware	17.1	44	Montana	8.9
12	Iowa	29.4	28	Maryland	16.4	45	North Dakota	7.6
13	Illinois	27.5	29	Oregon	15.5	46	Alaska	4.9
14	Tennessee	26.7	30	Wisconsin	15.3	47	Arizona	3.4
15	Idaho	24.5	31	Michigan	15.2	48	New Mexico	2.9
16	Minnesota	24.3	32	Louisiana	14.5	49	Nevada	0.6
17	Ohio	24.3	33	California	14.3	50	Wyoming	0

There is a clear regional pattern. Parts of the country settled first already had strong private institutions in place before the trend to provide public ones developed. They tend to have a large percentage of private enrollment. Western states initiated public higher education before strong private institutions could be established, and have low percentages.

A case can be made that private colleges and universities -- and for that matter elementary and secondary schools -- save tax money by serving students who would otherwise be served at public expense. The national figure for higher education is about $12 billion, derived by multiplying the private students by the appropriations per student at public institutions.

State Policy And Private Higher Education: The diverse state policies that encourage strong private institutions in the states at the top of Table 5 show that much more than "privatizing" a function is involved. In New Hampshire and Vermont, state and private institutions compete as they do in other states, but the state schools have little cost advantage because state subsidies per student are low and tuition is extremely high by national standards. In Massachusetts, the state has refrained from being as tough a competitor as it might be by avoiding the establishment of a major university in the Boston area. The governor's education proposals would close several existing state institutions. In New York, the state institutions provide low-tuition competition in all areas, but the state provides substantial subsidies to the private institutions as well as extensive scholarship and loan programs that students can carry to private schools.

There is continuing controversy between the public and private institutions, particularly over direct state subsidies for the private institutions. Pennsylvania is likely to be a center of the controversy this year. The governor's budget seeks roughly level funding for public institutions while proposing cuts in the 30-60% range for the 11 private institutions receiving state aid. For example, the University of Pennsylvania (a private Ivy League institution) would lose about $19 million out of $38 million. Its officials blame the state budget for their plan to hike an already scheduled increase in tuition and to lay off faculty.

Privatizing Health: The shift in paying for hospital care through third party reimbursements (e.g., Medicaid) continues to encourage the shift of hospitals from the public sector to private or private not-for-profit status. This trend affects state governments directly in only a few cases (e.g., Louisiana and Mississippi) for general hospitals but seems to be indirectly affecting decisions on mental health institutions and university teaching hospitals. Several states have hospital closing issues as part of their budget process this year.

Other Privatization: Governor Voinovich recently proposed that Ohio get out of the liquor store business, generating $45 million in the next biennium in the process. The move would affect 1,100 workers who staff about 260 state-run stores. They would shift to privately managed facilities similar to the 138 "agency stores" now serving less populated areas. In New Jersey, Governor Florio has suggested ending the state-run system of inspecting vehicles for safety and emission control equipment, turning the work over to licensed service stations (as is done in most states).

"Publicization": From time to time, legislators introduce bills for public takeover of a function when they are dissatisfied with private management decisions or prices. Last year, legislators unhappy with high air fares within California proposed the state start its own airline, Golden State Air. The bill was serious enough to be reported out of committee in the Senate. The supporters' campaign used T-shirts featuring the state animal (the California bear) and the slogan, "Smash the Fare! Ride the Bear." Amid concerns over socialism and doubts over state competence to manage existing functions, much less new ones, the bill failed on the Senate floor.

Proposals for the states to manage insurance activities have an inconsistent history. About a decade ago, Kansas established a fund for dealing with large medical malpractice damage awards. State officials are now looking for a way to end the function, just as Pennsylvania and New Jersey have ended parallel funds for auto insurance. But last year, California established a new state-run plan for earthquake insurance.

Selling Assets: In his late January deficit-reduction plan, newly-inaugurated Governor Weld announced Massachusetts would raise $390 million from the sale of assets, $90 million during the fiscal year ending in June. Details weren't settled, but press speculation picked out many of the transactions contemplated and suggested that some might not be consummated and, if consummated, might not be consummated on the schedule assumed in the deficit reduction plan. Included were federal purchase of land for a court house and surplus land on mental hospital sites. He also announced another $140 million would come from "sale of certain land and water rights." This was reported to be a transfer of a reservoir from the state to a state authority. Cash would flow to the state from the authority and to the authority from the purchasers of its water. A similar transaction might be undertaken with the Massachusetts Port Authority by which it would buy a state-owned office building and then charge state agencies rent for continuing to occupy it. Sale-leaseback of office space was also considered along with simply borrowing money secured by state buildings, which Weld views as comparable to taking a home equity loan.

By the time the legislature acted on FY 1991 budget balancing legislation, the proposals had narrowed to a sale under $100 million. A reluctant legislature provided the authorization, including waivers of bidding and related procedures for state asset sales, but wouldn't give the governor the power to make the sale to the state's industrial facilities authority. The rest of the asset sales will probably be considered as the FY 1992 budget is debated.

The New Jersey budget contains no new taxes and only one major revenue raising measure -- a $400 million sale of existing roads to the New Jersey Turnpike. New York City officials have considered asset sales to balance their budget for the past several years. One of the New York City proposals this year is to sell the land under the city's major airports. Albany County (NY) has been pushing a similar plan. In his 1990 campaign, the unsuccessful Republican candidate for governor of New York advocated selling the New York City airports, the Port Authority of New York and New Jersey, and the Triborough Bridge and Tunnel Authority.

Government Competition With The Private Sector: In a broad sense, many state-financed activities are in competition with the private sector. Public schools and state universities compete with private schools, state-subsidized transit competes with cars and taxis, state mental health institutions compete with private clinics and doctors, and more. There is also competition in a more narrow sense -- a state-run activity with private sector competitors. The Business Coalition For Fair Competition (1725 K St., NW, Washington, DC 20006) has been pushing legislation in individual states to limit commercial-type activities of state government. The types of activities that are of concern include university bookstores, state-run- resort hotels at state parks, and the activities of prison industries.

Privatization And State Employment: Even the most decisive privatization and facility closing measures don't necessarily work a permanent reduction in state labor forces. In West Virginia, which began its massive budget-cutting efforts after the inauguration of Governor Caperton in early 1989, there hasn't been enough money to permit major new state initiatives that would expand employment. But there have been hospital closings and liquor stores have been turned over to the private sector. The results were a reduction of 6% in employment in the first year, but an increase of 0.7% from January of 1990 to January of 1991. Per employee payroll has increased by 16.6% from October of 1988 to January of 1991.

SCHOOL FINANCE EQUALIZATION

Introduction: New Jersey and Texas illustrate the potential of school finance equalization decisions to complicate the finances of nearly every state. In a nutshell, New Jersey raised state taxes substantially for equalization last year, incurred voter wrath over how the legislature handled school finance and taxes, revised the school aid plan this year, and still isn't protected against either voter wrath or another adverse court decision. In a nutshell, Texas raised a tax and changed its school aid formula to deal with a court decision, had its revised formula thrown out by the state supreme court, developed a new school aid plan this year, had the revised formula rejected in the legislature, and now is likely to raise taxes to deal with equalization.

WHAT IS EQUALIZATION?

To keep it simple, consider only three school districts, with one pupil each, but with differing local tax base per pupil -- one district at the state average, one twice the average, and one half the average. The districts each levy a property tax at 1% of the market value of property and receive state aid of $2,000 per pupil. Their finances are:

Total Revenues Per Pupil In Three Districts

Source of Revenue	Poor	Average	Rich	Total
State Aid	$2,000	$2,000	$2,000	$6,000
Local Property Tax	1,000	2,000	4,000	7,000
Total	$3,000	$4,000	$6,000	13,000

A child in the rich district gets $6,000 worth of education while, though taxpayers pay the same tax rates, a child in the poor district gets only a $3,000 education. The essence of the equalization decisions is to require that the state make these per pupil spending numbers substantially equal when local taxpayers made substantially equal efforts, as measured by their local tax rates.

Litigation is at some stage in at least half the states. More will likely be added as those interested in education spending see these demonstrations of the power of litigation to induce higher state support of school spending. The basis of litigation is the differing provisions of state constitutions, but litigation is a possibility even in states with past court cases indicating their state constitutions don't require equalization. Litigation is underway in Alabama, even though the state constitution doesn't have an education provision parallel to those in other states. Because of changing definitions of equalization, litigation is even possible in states (e.g., California and New Mexico) that have equalized by prior criteria.

Increasing State Aid As A Solution: The courts haven't mandated how much be spent on schools, only that a student's educational opportunity (as measured by the spending in his district) not be a function of the richness (tax base per pupil) of where he lives. Thus, states could move toward equalization by terminating state aid to rich districts and concentrating it on poor ones. This approach would require the richer districts to increase local taxes sharply or make major cuts in their spending, so the approach hasn't been popular.

The traditional approach, evidenced by what Texas did last year, is to provide level funding ("hold harmless") to the richer districts or even a small increase while providing significantly larger increases to the poorer districts. This approach is expensive for the state. It took a tax increase in Texas and the plan included projections of future increases in aid that are likely to require another increase in the future. The approach doesn't provide complete equalization but often has provided enough progress toward equalization to satisfy the courts. This was the hope in Texas.

MOVING TOWARD EQUALIZATION

With about a 16% increase in state aid, the disparities in per pupil spending can be reduced substantially if assistance is concentrated on the poor districts. But the rich district still enjoys a substantial advantage.

Total Revenues Per Pupil In Three Districts

Source of Revenue	Poor	Average	Rich	Total
State Aid	$2,900	$2,100	$2,000	$7,000
Local Property Tax	1,000	2,000	4,000	7,000
Total	$3,900	$4,100	$6,000	14,000

Problems With Equalizing By Added State Aid: The example above illustrates the two basic problems with equalizing by spending more money on state aid. The first is that it is very expensive. Trying to use state money alone to bring below-average districts to average is expensive even in static terms, and even more expensive when the average itself is rising. Equalizing to the very richest district in the state imposes even higher costs. The second problem is that equalizing mechanisms like that chosen by Texas and typically by other states don't achieve complete equalization. As a result, they are vulnerable to further litigation. In Texas, the supreme court rejected the legislature's earlier efforts and set an April 1 deadline for a new plan.

Cutting Aid To Richer Districts: The fiscal pressures on state government combined with litigation on fairness in school finance are leading states to explore ways to eliminate fiscal disparities among districts without using state money. One is to cut the programs that provide more aid per pupil for richer districts than for poorer ones. Certain demonstration programs, involving local ingenuity in preparing applications and/or a local match, tend to do this. So do special programs for the gifted. But these are small items compared with pension funding. Because rich districts tend to have more teachers and administrators in relation to the number of students and to pay staff better, the per pupil pension costs of rich districts are much greater than those of poor districts. So when states pay these costs, as many do, the state contribution per pupil is greater in rich districts than poor ones. Eliminating separate state support of pension and employer Social Security costs (and other benefits in some states) is highly equalizing. Continuing state sharing of such costs, but putting them in the school foundation (equalization) program has a similar effect.

HOW A FOUNDATION FORMULA WORKS

Most states use some variation of a foundation formula for school finance. The concept is a state guarantee of a minimum school program which can be stated in dollars per pupil or priced based on the number of pupils, the class size, the cost of teachers, etc. From this minimum is subtracted a local effort requirement, typically a tax rate times the local tax base. A rich district may raise so much from the stipulated tax rate that it is "out of formula" and entitled to no state aid. A poor district will have a smaller local effort subtraction than an average one and thus get more state aid. Depending on the state, many costs like pupil transportation, special education, educational quality programs, teacher retirement, and more may be "above the line," that is provided with no consideration of local revenue raising ability. Putting such costs into the formula subjects their costs to the subtraction of the local effort requirement which makes no difference to districts "in formula" but costs "out-of-formula" districts. Raising the local effort requirement reduces the state aid for all districts, but reduces it the most for rich districts.

While the mechanism is much more complex, another highly equalizing approach is to raise the minimum property tax in the traditional school aid formula. Statewide, that move raises the amount of school spending to be paid with local dollars. The savings are then used to increase the per pupil costs of the minimum education program. Even if no added state dollars were provided, the shift would provide more state aid to poorer districts and reduce funding to rich districts -- whose local effort requirement goes up more than average. For example, the South Dakota House has already approved a minimum levy requirement.

Many of the measures that cut aid to rich districts are under discussion this year. In Florida, the proposal is a decategorization of state school aid. In Massachusetts and Pennsylvania, governors' proposals would put some elements of pension costs into local cost responsibility and away from direct state reimbursement.

The inherent political problem with these measures is that they tend to force the districts affected into choosing between cutting back school programs and going to local voters for increased taxes. This is, of course, exactly the effect they are supposed to have for equalization purposes, but the voter reaction isn't favorable, if New Jersey is an example, and the reaction from administrators and teachers certainly isn't. In the revisions this year, New Jersey reversed itself on some of these policies.

Making Rich Districts Less Rich: The equalization problem arises from a disparity of tax base among districts. Instead of helping the poor by giving added money, another approach is to make the rich less rich, potentially using the resources to aid the poor. Put another way, instead of leveling by building up all surrounding land to the height of the hill, why not skim down the hill and use the excess dirt to fill any valleys?

This approach is to reduce the "excess" tax collecting abilities of the rich districts. Choices: (1) taking away some local revenue and giving it to other districts, a politically unpopular Robin Hood device generally avoided, (2) a statewide property tax (or its equivalent) as used in New Mexico and discussed seriously (as a regional tax) in Texas, and (3) sharing some portion of the tax base such as: (a) large chunks of business property as in Mississippi, (b) new business property shared regionally as in Minnesota's Twin Cities area, or (c) some portion of property growth shared statewide. The statewide distribution of growth is being pushed in Michigan by some key legislators and the governor. Ohio's governor has expressed interest as a way of dealing with litigation just getting underway.

Developments In Texas: Working under the April 1 state supreme court deadline, Texas legislators have been laboring over new school finance methods. The changes being considered are designed to provide each Texas school district nearly equal dollars per pupil from equal local tax rates. The substance of the change is to create what amounts to a statewide property tax, while avoiding the constitutional constraint against such a tax. To take the money discretely from the more affluent districts, regional taxing districts would be established.

After approval by a conference committee, the measure failed in the House. This puts the state at risk of having the school aid distributions enjoined after the deadline or having the courts write and implement a new school aid formula. Though some Texas legislators worry about these possibilities, either would be extraordinary for an elected state supreme court. The more likely possibility is that school finance issues will be revived in the legislature, perhaps in conjunction with the budget when it is considered this summer. The result is likely to include both a major revision of school finance and of state finance, as many Texas leaders believe the combination of the rejection of the lottery, the school finance issue, and the regular budget will require a tax increase -- perhaps even adoption of an income tax.

STATE FINANCES: PAUSING FOR DECISION?

Momentous Decisions? Is 1991 the year of decision for Americans as they finally face issues of how much public service they want and are willing to pay for? The theme can be overemphasized and is a little broad for **Reports**, which likes generalizations more closely grounded in facts. But this year in the larger states, the broad choice is between holding the line on taxes and significantly cutting services or holding the line on services and significantly raising taxes.

The tax increase alternative is unacceptable to many elected officials. Many have explicit and recent campaign commitments on the subject. Many fear voter reaction. Many are positive that raising taxes will only lead to raising spending, which they believe can be curtailed without harming essential services. Many believe all these things.

The spending alternatives actually before elected officials aren't soft choices like cutting waste and abuse. They are choices that involve denying raises to state employees and teachers, pushing more costs onto property taxes, eliminating cash assistance for those who can't work or can't find jobs, cutting access to state universities through higher tuition and/or enrollment caps, and other equally difficult policies.

Because the issues are complex, the locus of decision in many different states, and the issues obscured by mechanical views like costs of keeping the doors of state government open, they aren't much noticed as a national phenomenon. Even though the state decisions on tax increases in 1991 are likely to result in a bigger bite on the nation's taxpayers than the much discussed federal increases of 1990, they will draw much less attention -- again because the decisions are decentralized and not made all at one time. But with the federal government committed by last year's budget agreement to stable policy, the decision on whether the nation does more or less in education and particularly social services is now being made in the state capitols.

Avoiding The Choices: In many large states, the spring is a period of doing nothing, or not very much. In many states, the legislative reaction to governors' proposals has been negative. Legislators in California don't like the governor's proposed cuts in education and human services. Legislators in New York and Massachusetts aren't comfortable with local aid cuts. Michigan and Illinois legislators have reservations over combining local aid cuts and state mandates of property tax relief. Texas legislators don't like the fiscal constraints of the Legislative Budget Board's budget, nor the legal constraints the state supreme court is putting on their school finance decisions.

One reaction is to let time pass, waiting for the situation to gel. This is consistent with waiting for late spring final revenue estimates, as is the custom in California and some other states. But lack of decision on what strategy to pursue is also a factor. This is particularly apparent in New York, which is scheduled to act more rapidly than other states because its fiscal year begins in April rather than July. On March 19, the New York Times assessed the situation this way: "Unwilling to approve many of the proposed cuts offered by Gov. Mario M. Cuomo, but lacking a politically palatable alternative, the state's legislative leaders seem to have adopted a wait-and-see attitude."

Cash Pressures: New York fiscal guru Felix Rohatyn attributes fiscal inaction, at least in New York, to the absence of a fiscal crisis comparable to the one in 1975 when financial markets refused to loan New York City money. As he puts it, "The good news compared to the 1970s is the money won't stop tomorrow, but the bad news is that the money won't stop tomorrow." For 49 states, cash is not a problem -- often inconvenient to raise, sometimes expensive, but available. The hurdles against borrowing aren't financial, but governmental -- constitutional prohibitions against borrowing, inability to get legislative majorities to support borrowing because cash is seen as fiscal discipline, etc. If they need cash, most states have ample mechanisms to get it if they are willing to follow some of the techniques used by a few states -- delayed payments to vendors, delays in aid to local government, accelerating tax payments, and borrowing from other state funds.

Massachusetts has already run through this list and, unlike all but a few other states, has already borrowed money to cover operating deficits. It now needs money to: (1) repay money already borrowed, (2) finance continuing deficits, and (3) finance capital outlays. The state's bond rating is the lowest in the nation, and thus the interest rates it pays about the highest. Rating agencies are warning that the rating could drop to junk bond (below investment grade) status. The state treasurer is warning that the Bay State is almost out of cash. The measures the legislature has taken or is considering, regardless of their merits, read like a list of what to do to lower a bond rating: (1) repeal a tax -- the sales tax on services -- without replacement revenue, (2) stretch out payments on existing debt, (3) lower contributions to an underfunded pension plan, and (4) borrow money indirectly by selling assets and then leasing them back.

MISCELLANY

Corporate Income Taxes: Flanked by New Jersey's governor and its commerce commissioner, the head of Bristol-Myers Squibb announced that the firm will build a $100 million pharmaceutical complex in the Garden State, rather than sites it had considered in Indiana and Pennsylvania. The company president cited several reasons for the selection including the fact that the site was next to the company headquarters and the state's regulatory cooperation. There were no special tax concessions and the company president noted Indiana has lower taxes but said "taxes are only one consideration." The governor, predictably, touted the decision as did the commerce director. He cited New Jersey's "formidable" position relative to competitor states based in part on the corporate income tax rate and reminded the audience that New Jersey didn't raise corporate taxes in its tax increase package last year.

Table 6 shows the tax rate applicable to an additional dollar of earnings by a large corporation in the 50 states as of March 1991. Among the states potentially competing for the facility, there are contradictory trends. In Connecticut, the governor has proposed a decrease while Pennsylvania's governor has proposed an increase. In most states, there is no consideration of corporate rate adjustments, up or down.

In at least some situations, corporate income tax increases aren't objected to by major business organizations. Examples are education quality measures in Kentucky and Mississippi and a plan to improve vocational education by increasing the corporate rate by 0.5% that is passing the Arkansas legislature with the support of the state chamber, the manufacturers' association, the business council, and other business groups. The Illinois state chamber fought strongly against the "temporary" personal and corporate tax hikes enacted two years ago, but supports renewal now that they are due to expire.

Table 6: Corporate Income Tax on $100 of Added Income

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Connecticut	13.80%	18	Idaho	8.00%	35	Florida	5.50%
2	New York	10.35	19	Iowa	7.92	36	Colorado	5.30
3	Rhode Island	9.99	20	Wisconsin	7.90	37	Louisiana	5.28
4	Minnesota	9.80	21	Nebraska	7.81	38	Mississippi	5.00
5	Massachusetts	9.50	22	New Mexico	7.60	39	South Carolina	5.00
6	New Jersey	9.42	23	Maryland	7.00	40	Utah	5.00
7	Alaska	9.40	24	North Carolina	7.00	41	Illinois	4.80
8	Arizona	9.30	25	North Dakota	6.93	42	Missouri	4.29
9	California	9.30	26	Montana	6.75	43	Indiana	3.40
10	West Virginia	9.30	27	Kansas	6.75	44	Alabama	3.30
11	Ohio	9.20	28	Oregon	6.60	45	Michigan	2.35
12	Maine	8.93	29	Hawaii	6.40	46	Nevada	0
13	Delaware	8.70	30	Arkansas	6.00	47	South Dakota	0
14	Pennsylvania	8.50	31	Georgia	6.00	48	Texas	0
15	Kentucky	8.25	32	Oklahoma	6.00	49	Washington	0
16	Vermont	8.25	33	Tennessee	6.00	50	Wyoming	0
17	New Hampshire	8.00	34	Virginia	6.00			

Gambling: The spread of legalized gambling continues. Georgia's lottery will be on the 1992 ballot and lottery proposals are under serious consideration in other states. Deadwood (SD) gambling operations have proved a serious tourist draw, stimulating proposals in neighboring states to provide something similar. Iowa's riverboat gambling began on April 1, with the first Illinois competitor scheduled to sail in July. Iowa has made the decision that when the Mississippi

River isn't navigable, gambling will continue with operators "simulating" a cruise. Illinois has opened the door to joint promotions with tie-in advertising with United Airlines in a "Cash 'n' Fly" lottery game with tickets and cash prizes.

Public Opinion: Recent polls in several states suggest that the public continues to prefer sales to property or income taxes. Above any of these, people prefer taxes they don't perceive themselves as having to pay -- particularly taxes on corporations, the rich, smokers, and drinkers.

A February California Poll found 59% of respondents believe that state and local taxes are "somewhat high" (26%) or "much too high (33%), up slightly from 55% that picked one of these two categories five years ago. Asked to pick from three alternatives as a temporary way to relieve the state's deficit, 57% found a half-cent sales tax acceptable, 40% found a 10% income tax increase acceptable, and only 29% found a 10% property tax hike acceptable.

A higher education group surveyed Missouri residents, finding majority support for a tax increase for higher education if it would lead to various improvements listed in the question. When the question was phrased in terms of specific taxes, the support was highest for the corporate income tax (66%), sales tax (52%), sales tax on services (34%), and personal income tax (34%).

The University of Connecticut recently surveyed a sample of Connecticut residents on their attitudes toward the governor's plan to adopt a new income tax while lowering sales and business taxes. About 75% said the income tax debate misses the point, with the real issue being what citizens can afford to pay. Asked, "Assuming the same amount of additional money would be raised, would you prefer an income tax, prefer raising other taxes instead, or do you not prefer either alternative?" 40% opted for neither, while 29% took the income tax and 20% took unspecified other taxes. But they didn't like available budget cutting alternatives much. There was 58% support for "reducing state aid now given to wealthier towns," but only 47% for laying off state workers, 42% for canceling cost-of-living increases for state workers, and only 34% for canceling cost-of-living increases for people on welfare.

A similar poll in Massachusetts in February found 70% support for drastic cuts in state government but less support for specifics: 56% for furlough for state workers, 61% for increasing state employee contributions to health insurance, 64% for deferring raises for state workers, 63% for higher transit fares, 63% for limiting general assistance, and 55% for eliminating the higher education board of regents. But only 46% supported (44% opposed, rest don't know) laying off 6,000 state workers and only 16% wanted to close some state colleges.

TECHNICAL NOTES

Education: For an upbeat description of how much new is being proposed for education in the governors' budgets, see Governors' Weekly Bulletin (3/1).

Alternatives To Incarceration: The U.S. Department of Justice, Office of Justice Programs, performs exactly the clearinghouse, statistics gathering, and research leadership functions that state officials often urge as an appropriate minimum federal role in many areas of domestic policy. The information on boot camps and electronic monitoring comes from the agency's NIJ Reports (Nov./Dec. 1990), but with a phone call or letter to the agency, state officials can get citations to studies, statistics, descriptions of programs, and more. The data on Table 3 come from the National Council on Crime and Delinquency (685 Market St., San Francisco, CA 94105).

Privatization: The General Accounting Office (Washington, DC 20548) report (Private Prisons: Cost Savings and BOP's Statutory Authority Need To Be Resolved) was issued in February. The report includes an inventory of private prison facilities and a review of studies of the concept. The Privatization Committee of the Public Employee Department, AFL-CIO (815 16th St., N.W., Washington, DC 20006) keeps track of privatization issues around the country with results published in its Privatization Update. For anecdotal summaries of how the Chelsea school experiment is going, see "Not A 'Miracle' Cure," Newsweek (9/17/90) and "The Lessons Learned When College Officials Run Public Schools," New York Times (7/11/90). The Table 5 data come from The Preservation Of Excellence In American Higher Education: The Essential Role Of Private Colleges And Universities (Education Commission of the States, 707 17th St., Denver, CO 80202). The Privatization Council publishes Partnership Focus, a monthly magazine dealing with privatization issues.

There is no shortage of books on privatization. John Donahue (Harvard), The Privatization Decision (Basic Books, 1989) argues the key issue is not private or public provision but making sure that competition is provided. Also see Lawrence Finley (ed.), Public Sector Privatization (Quorum Books, 1989), Randall Fitzgerald, When Government Goes Private (Universe Books, 1988), Lester Salamon (ed.), Beyond Privatization (Urban Institute, 1989), E.S. Savas, Privatization: The Key To Better Government (Chatham House, 1987), and Joan Allen and others, The Private Sector In State Service Delivery (Urban Institute, 1989).

School Finance Equalization: For a summary of the legal principles in the equalization cases, see Thomas Stubbs, "After Rodriguez: Recent Developments In School Finance Reform," The Tax Lawyer (Fall 1990).

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VOLUME 9 ISSUE 8

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Hiking personal income tax rates wasn't high on governors' priority lists for raising money, but interest may be growing. Top bracket rates are an issue in many states.

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Confronting spending they consider excessive with no obvious way to make cuts, many state officials are looking to task forces and experts. Past results of such efforts cast doubt on future performance.

o Studying How To Save Money p. 12

A survey of governors' budgets shows state fiscal problems to be serious. They have worsened since the governors submitted their proposals.

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Miscellany deals with block grants, borrowing, cross subsidies, farm states, furloughs, local finance, legislative staffing, financial problems in Massachusetts, pension funds, Rhode Island's problems, state budget practices, and tax increases. Technical notes indicate data sources and provide a special table on where states get their money.

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April 1991 (Second of Two April Issues)

THE BALANCED TAX SYSTEM

Introduction: Most states finance state and local spending through a combination of three major taxes: (1) income, (2) property, and (3) sales. Other income sources -- fees, federal aid, severance taxes, fines, interest earnings, and more -- also contribute. The three taxes are the mainstay of state-local finance, except in extraordinary circumstances like Alaska's ability to rely on oil wealth. But a few states do without a sales tax, ten do without a personal income tax on wages and salaries, and many states differ from national patterns in how much they rely on each of these sources.

The Concept Of Balance: The concept of a "balanced tax system" has received considerable attention in state tax discussions. The notion, which varies slightly depending on its proponent, is that states should use the property, income, and sales tax bases in roughly equal proportion in their revenue raising. The theory is most closely associated with John Shannon (Urban Institute), who pushed it while with the Advisory Commission on Intergovernmental Relations.

Arguments For Balance: There are substantive tax policy arguments for the concept in terms of fairness to taxpayers in differing circumstances, stability of revenues, and other traditional tax policy criteria. The economic development argument is that to maintain "adequate" or "likely" spending patterns without using all three taxes about equally means that the taxes that are used will have extraordinarily high rates. Thus, they will become a "sore thumb" for development purposes. The stability argument holds that over-reliance on income taxes will impart too much instability to state and local revenues, a problem which can be reduced if property taxes are a substantial part of the revenue mix.

Table 1 presents the percentage of total revenue from the three major taxes that is raised from each of the three. The data, which cover state and local governments, were calculated by **Reports** from a newly released Census Bureau report, Government Finances In 1989.

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Table 1: Percent "Big Three" Tax Collections From Each Tax, FY 1989

Property Taxes			Sales Taxes			Income Taxes		
Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New Hampshire	71.9%	1	Nevada	74.9%	1	Delaware	63.6%
2	Wyoming	62.9	2	Washington	68.6	2	Maryland	44.0
3	Montana	52.2	3	Tennessee	67.0	3	Massachusetts	42.3
4	Alaska	51.8	4	New Mexico	64.4	4	Oregon	41.1
5	Oregon	48.9	5	Louisiana	60.5	5	North Carolina	39.4
6	New Jersey	46.1	6	Florida	59.2	6	New York	39.2
7	South Dakota	45.0	7	Alabama	57.1	7	Kentucky	38.0
8	Texas	44.7	8	Texas	55.3	8	California	36.7
9	Nebraska	43.9	9	Mississippi	54.0	9	Alaska	36.0
10	Connecticut	43.0	10	Hawaii	52.7	10	Ohio	35.9
11	Vermont	42.4	11	South Dakota	52.0	11	Michigan	34.5
12	Rhode Island	40.5	12	Oklahoma	51.9	12	Virginia	33.8
13	Michigan	40.4	13	Arkansas	51.1	13	Minnesota	33.6
14	Kansas	38.6	14	Arizona	47.6	14	Pennsylvania	33.4
15	Iowa	38.3	15	North Dakota	47.0	15	Hawaii	32.9
16	Colorado	37.3	16	West Virginia	47.0	16	Wisconsin	32.4
17	Illinois	37.3	17	Missouri	46.5	17	Georgia	32.3
18	Wisconsin	37.1	18	Kentucky	43.2	18	West Virginia	32.0
19	Florida	36.9	19	South Carolina	42.8	19	Idaho	31.4
20	Maine	36.1	20	Utah	42.3	20	South Carolina	31.0
21	North Dakota	35.1	21	Connecticut	40.4	21	Montana	30.7
22	Arizona	34.4	22	Illinois	40.4	22	Missouri	30.2
23	Massachusetts	34.0	23	Indiana	40.0	23	Arkansas	29.8
	United States	**33.0**	24	Georgia	39.4	24	Iowa	29.7
24	New York	32.3	25	Idaho	39.2	25	Maine	29.6
25	Virginia	32.3	26	North Carolina	38.8	26	Alabama	29.4
26	Minnesota	32.3		**United States**	**38.4**		**United States**	**28.6**
27	Indiana	31.4	27	Wyoming	37.1	27	Indiana	28.6
28	Washington	31.4	28	Colorado	37.1	28	Rhode Island	27.5
29	Pennsylvania	31.2	29	Kansas	35.5	29	Utah	27.0
30	Utah	30.7	30	California	35.5	30	Oklahoma	26.4
31	Ohio	29.9	31	Pennsylvania	35.3	31	Kansas	25.9
32	Idaho	29.4	32	Nebraska	34.5	32	Vermont	25.8
33	Georgia	28.3	33	Maine	34.3	33	Colorado	25.6
34	California	27.8	34	Ohio	34.2	34	New Jersey	23.7
35	Mississippi	26.8	35	Minnesota	34.1	35	Illinois	22.3
36	Maryland	26.8	36	Virginia	33.8	36	New Mexico	21.6
37	South Carolina	26.2	37	Rhode Island	32.0	37	Nebraska	21.6
38	Nevada	25.1	38	Iowa	31.9	38	Louisiana	19.4
39	Tennessee	25.0	39	Vermont	31.8	39	Mississippi	19.1
40	Missouri	23.3	40	Wisconsin	30.5	40	Arizona	18.0
41	North Carolina	21.8	41	New Jersey	30.1	41	North Dakota	17.8
42	Oklahoma	21.7	42	Maryland	29.2	42	Connecticut	16.6
43	West Virginia	20.9	43	New York	28.4	43	New Hampshire	11.6
44	Louisiana	20.1	44	Michigan	25.0	44	Tennessee	8.0
45	Delaware	19.5	45	Massachusetts	23.7	45	Florida	3.9
46	Arkansas	19.0	46	Montana	17.1	46	South Dakota	3.1
47	Kentucky	18.8	47	Delaware	16.8	47	Nevada	0
48	Hawaii	14.3	48	New Hampshire	16.5	48	Texas	0
49	New Mexico	14.0	49	Alaska	12.3	49	Washington	0
50	Alabama	13.5	50	Oregon	10.1	50	Wyoming	0

There is no single rigorous definition of what constitutes balance in a tax system. The national average mix among the three taxes is 38% sales taxes, 33% property taxes, and 29% income taxes. If balance is defined as not relying on any one of these taxes for more than 40% of revenue from the three together, nor using any one for less than 20%, the states with balanced tax systems are: California, Colorado, Georgia, Idaho, Iowa, Kansas, Maine, Minnesota, New York, North Carolina, Ohio, Pennsylvania, Virginia, and Wisconsin.

Current Balance Issues: There are major efforts underway in many of the states showing the least balance on Table 1 to provide more balance. Of course, the rallying cry is not "We need a balanced tax system." Instead, the cry is typically a concern that a particular tax is too high in terms of ability to pay and relative to competing states.

Of the 13 states on Table 1 with greater than 40% property tax reliance: two (Alaska and Wyoming) rely heavily on resource taxes not shown on the table, two (Nebraska and New Jersey) have raised other taxes to reduce property tax reliance, one (Oregon) has a new property tax limit likely to force increases in other taxes, and another (Michigan) has a limit proposal pending. Other taxes were increased in Rhode Island and are likely to be in Vermont to avoid a deficit and pressures on local finances. Major income tax proposals are pending in Connecticut, Texas, and New Hampshire.

Change is less likely in the 13 states with more than 50% sales tax reliance. Major reform proposals in Louisiana and Washington have been defeated in the past and are on hold this year. Nevada is adopting a payroll-type tax. Tennessee and Texas are considering income taxes. But a sales tax increase was adopted in Arkansas and is the current favorite revenue raising idea in South Dakota. In the four states with over 40% reliance on the income tax: (1) little change is expected in Delaware, (2) the governor proposed increasing the income tax in Maryland, but the proposal was rejected in the legislature, (3) the sales tax was extended to services in Massachusetts, but the concept was repealed before implementation, and (4) Oregon is considering a sales tax.

Arguments Against A Balanced Tax System: One argument against a balanced tax system is that certain states don't need all the money that using all three taxes would provide. One of the reasons is high reliance on non-tax revenues such as hospital charges, university tuition, and fees for state services. Table 2 shows the percentage of state and local revenue (excluding federal aid) received from such charges, interest, and sundry other payments.

Table 2: Non-Tax Charges As A Percentage Of Own-Source Revenues, FY 1989

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Alaska	59%	18	Tennessee	33%	34	New Hampshire	28%
2	Wyoming	49	19	Colorado	33	35	Michigan	28
3	New Mexico	43	20	Oklahoma	32	36	Ohio	27
4	North Dakota	41	21	South Carolina	32	37	Virginia	27
5	Louisiana	39	22	Indiana	32	38	Missouri	27
6	Delaware	38	23	Texas	32	39	North Carolina	27
7	Mississippi	37	24	West Virginia	32	40	Wisconsin	26
8	Alabama	37	25	Georgia	31	41	Rhode Island	26
9	Florida	35	26	Iowa	31	42	Pennsylvania	26
10	Utah	35	27	California	31	43	Hawaii	25
11	Montana	34	28	Idaho	31	44	Maine	24
12	Nebraska	34	29	Kansas	30	45	Maryland	24
13	South Dakota	33	30	Washington	30	46	New Jersey	24
14	Kentucky	33	31	Arkansas	29	47	Illinois	23
15	Oregon	33	32	Arizona	29	48	Massachusetts	23
16	Nevada	33		**United States**	**29**	49	New York	22
17	Minnesota	33	33	Vermont	28	50	Connecticut	21

At a time when elected officials are under great pressure to avoid tax increases while funding current programs, non-tax revenue sounds like an attractive alternative. In some states, particularly Massachusetts, considerable effort has gone into dealing with a low ranking on the counterpart of Table 2 for previous years.

However, the top-ranked states have two linked characteristics that most states can't match. They have revenues from public lands associated with resource development. Alaska leads the pack with oil royalties that exceed $2,000 per year per person. They also often have large trust funds capitalized by tax revenues and royalties from resource exploitation. From these trust funds, they get interest and dividend income -- a major non-tax revenue that less favored states don't have.

The other argument against balance is simply a preference for a particular tax or taxes and an aversion for others. For example, Oregon officials have asked voters to approve a sales tax many times, but they have rejected it. Many Southern states have historically maintained low property taxes with little sentiment to raise them and considerable concern that they are too high already. The status of states without income taxes is discussed in a separate article in this issue.

MEDICAID REIMBURSEMENT POLICY

> Thirty-seven states will spend more on Medicaid than they originally budgeted for fiscal 1991. Until this program is brought under control, state budgets are likely to remain in a state of severe stress and governors will be forced to scale back or abandon other program initiatives.
>
> Nat. Assn. of State Budget Officers, Fiscal Survey

> As New York struggles through a fiscal crisis, its ever-expanding Medicaid program, already the most expensive in the nation, has emerged as discouraging proof of just how profound and intractable the state's budget problems are.
>
> Elizabeth Kolbert, New York Times

Introduction: Fiscal problems have brought more attention to the issue of how much states should pay for health services under the Medicaid program. There are as many issues as there are types of providers, but most of the attention and money is associated with physicians, hospitals, and nursing homes.

Current Practice: As a general rule, states can pay providers any price that the states and providers agree upon. In practice, this has meant that the states have set the prices. Some providers accept them and serve Medicaid patients. Some don't. When enough don't, problems arise such as a shortage of nursing home beds and difficulty in finding maternity care in rural areas. Some providers, particularly hospitals, are subject to various federal requirements that they not turn away patients for economic reasons, but there are widespread allegations that these requirements are often avoided. In any case, they don't apply to non-critical cases.

One mechanism appearing in many state budgets this year is a freeze on reimbursement rates. In a few cases, governors have proposed lowering rates to reduce the rate of increase in Medicaid spending. For example, such a reduction is included in the Illinois governor's budget. The concept isn't new. Experiencing fiscal problems in 1986, Texas reduced its payments to 90% of scheduled payments. The proportional adjustment is now 94.5%. The most striking reduction this year was the 20% reduction in physician reimbursement in Michigan, which was accompanied by similar reductions to certain other providers but not hospitals.

Recent court cases involving hospitals indicate they may have a right to "reasonable" reimbursement. Michigan and several other states have reached agreements with their hospitals to avoid more costly results they fear from litigation. Nursing homes are seeking to work the same angle.

The federal guideline for reimbursements for physicians and providers generally is that payments be sufficient to enlist enough providers so that Medicaid beneficiaries receive covered services, at least to the extent they are available to the general population in their geographic area. This relatively loose guideline is being urged by some state social service agencies as a basis for avoiding reimbursement rate cuts for physicians.

Differing State Practices: Table 3 is a comparison of the Medicaid reimbursement rates for a visit to a doctor who has been seen before (so the costly process of developing a patient medical history isn't involved).

Table 3: Medicaid Reimbursement for Doctors Office Visit, 1989

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$45.00	18	New Mexico	$20.31	35	Delaware	$17.94
2	Massachusetts	41.00	19	Minnesota	20.00	36	Kentucky	17.77
3	Nevada	29.38	20	New Hampshire	20.00	37	Nebraska	17.70
4	Tennessee	27.00	21	Iowa	19.84	38	Oklahoma	17.50
5	Indiana	26.80	22	Utah	19.65	39	Missouri	17.00
6	Florida	25.00	23	Connecticut	19.50	40	Wisconsin	16.88
7	Georgia	25.00	24	Idaho	19.50	41	North Dakota	16.70
8	Kansas	25.00	25	Texas	19.50	42	Michigan	16.60
9	Arkansas	24.75	26	Virginia	19.00	43	Mississippi	15.00
10	Colorado	24.40	27	Ohio	18.91	44	Louisiana	14.28
11	Washington	22.62	28	Montana	18.84	45	New Jersey	14.00
12	Alabama	22.50	29	Oregon	18.81	46	Illinois	12.65
13	Hawaii	22.40	30	California	18.40	47	New York	11.00
14	North Carolina	21.88	31	Pennsylvania	18.00	48	West Virginia	10.00
15	Maine	21.25	32	Rhode Island	18.00	49	Arizona	n.a
16	Maryland	21.00	33	South Carolina	18.00	50	Wyoming	n.a
17	Vermont	21.00	34	South Dakota	18.00			

The median state pays just under $20. The rates for 38 states fall in the range between $15 and $25. Alaska pays a much higher rate, $45, while West Virginia pays only $10. The difference is conceivably explainable by differences in price levels and state financial condition. Not easily explained are different payments in Massachusetts ($41), New Jersey ($14), Illinois ($12.65), and New York ($11.00).

Contrasts With Medicare: Another approach to comparing physician reimbursement is to relate the Medicaid reimbursement to the Medicare reimbursement, as is done on Table 4. Medicare rates are set by the federal government, using an elaborate logic that seeks to capture differences in costs and prevailing prices in each area of the country.

Table 4: Medicaid Physician Reimbursement As Percent of Medicare

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Arkansas	120%	18	Oklahoma	78%	35	Maine	62%
2	Georgia	112	19	Texas	77	36	Michigan	62
3	Alaska	106	20	Idaho	76	37	Ohio	60
4	Indiana	102	21	Wisconsin	76	38	Missouri	57
5	Nebraska	99	22	North Dakota	75	39	Connecticut	56
6	Massachusetts	94	23	Montana	74	40	Rhode Island	55
7	North Carolina	93	24	Virginia	73	41	California	54
8	Tennessee	92	25	Alabama	72	42	Maryland	51
9	Iowa	91	26	Florida	71	43	Pennsylvania	51
10	Utah	89	27	Vermont	71	44	Delaware	50
11	Minnesota	86	28	New Mexico	69	45	Illinois	48
12	South Dakota	85	29	Washington	69	46	New Jersey	40
13	Colorado	81	30	New Hampshire	67	47	West Virginia	35
14	South Carolina	81	31	Louisiana	66	48	New York	30
15	Hawaii	79	32	Mississippi	66	49	Arizona	n.a
16	Kansas	79	33	Oregon	66	50	Wyoming	n.a
17	Nevada	79	34	Kentucky	63			

The table indicates that physicians are less well reimbursed for Medicaid patients than for Medicare patients, typically getting only about three-fourths as much for the Medicaid patient. There doesn't appear to be any particular regional pattern in the rankings of the states.

Consequences of Low Fees: The most obvious consequence of low fees is to reduce the cost of the Medicaid program. But for physician fees, there may be adverse consequences, such as making it harder for Medicaid recipients to get care in a doctor's office. This may discourage care, but may also redirect some care to more expensive providers.

Policy Change? It would cost on the order of $1.3 billion to raise Medicaid physician reimbursements to the Medicare levels. Besides wanting to avoid this cost, legislators may feel that physicians, who earn on average over $100,000 a year, may be adequately compensated, even if not from Medicaid. A direct or indirect federal mandate of higher reimbursement is a possibility, although other Medicaid mandates may interest Congress more. State decisions reflect the continuing trade-off between the scope of services provided, the persons eligible for service, and the reimbursement to providers. In broader perspective, the decisions reflect the trade-off between Medicaid and other programs and between all programs and tax levels.

As with other aspects of health care, there is considerable suspicion that attempts to trim costs in one area result in the same or higher costs appearing elsewhere. In the case of physician reimbursement rates, the immediate consequence is reduced physician participation. In New York, with its $11.00 per visit rate, second lowest in the country, only about 25% of physicians regularly treat Medicaid patients. This is believed to be one reason why many New York Medicaid recipients use high-cost hospital emergency rooms for their routine health care visits.

THE PERSONAL INCOME TAX

Introduction: Income taxes are one of the most contentious issues of state policy. Four states -- Nevada, Texas, Washington, and Wyoming -- don't use them for either corporations or individuals. But they are a mainstay of state revenue structures in most states, particularly the 40 that tax personal income of all types -- salaries and wages, dividends, and interest.

Income Tax Reliance: Table 5 shows the states with the highest and lowest reliance on income taxes by comparing the revenue received by state and local government from income taxes (corporate and personal) with the total receipts from income, sales, and property taxes. {All states are shown in Table 1.}

Table 5: Income Tax Revenues As Percentage Of Revenues From Big Three Taxes
Selected States, FY 1989

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Delaware	63.6%	8	California	36.7%	44	Tennessee	8.0%
2	Maryland	44.0	9	Alaska	36.0	45	Florida	3.9
3	Massachusetts	42.3	10	Ohio	35.9	46	South Dakota	3.1
4	Oregon	41.1		**United States**	**28.6**	47	Nevada	0.0
5	North Carolina	39.4	41	North Dakota	17.9	48	Texas	0.0
6	New York	39.2	42	Connecticut	16.6	49	Washington	0.0
7	Kentucky	38.0	43	New Hampshire	11.6	50	Wyoming	0.0

Three of the states in the top ten on this table have high reliance on income taxes because they make no use of the sales tax. Alaska, Delaware, and Oregon have no general sales tax, though they do have selective excises on some goods like motor fuel and tobacco products. Many of the states in the bottom ten have no income taxes or limited ones like Tennessee which taxes dividends, interest, and corporate income, but not wages and salaries.

Income Tax Burdens: The state income taxes have different structures. Some -- like those in Illinois and Pennsylvania -- have low flat rates with almost no exemptions and deductions. Others -- like those in California and Iowa -- have graduated rates and extensive exemptions and deductions. As a result, no single statistic adequately compares state tax levels. Two standard statistics, covering both state and local income taxes, are tax effort (States In Profile, Table D-19) and income taxes as a percent of personal income (Table D-11).

New York has the highest income taxes by both criteria. A scheduled reduction has only been partly implemented because of the state's fiscal problems.

Top Bracket Rates: Top bracket rates are of interest from several perspectives. From one, a high top bracket rate combined with low bottom bracket rates and generous personal exemptions is indicative of an appropriately progressive tax system that taxes in accord with ability to pay, yet raises enough to finance adequate service levels. From another perspective, high rates are economic red flags that discourage business from locating and expanding in a state. Arguably, high rates also encourage individuals to get out while working if they can, otherwise, when they retire. Top bracket rates for Table 6 are defined as the added state tax due on an additional dollar of income earned by someone who already has income of $100,000.

Table 6: Top Bracket Marginal Personal Income Tax Rates, March 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	10.00%	18	South Carolina	7.00%	35	Louisiana	4.14%
2	California	9.30	19	Wisconsin	6.93	36	Missouri	4.14
3	Oregon	9.00	20	Nebraska	6.92	37	Alabama	3.45
4	Vermont	8.68	21	Ohio	6.90	38	Indiana	3.40
5	Rhode Island	8.52	22	Iowa	6.89	39	Illinois	3.00
6	Maine	8.50	23	Arizona	6.50	40	Pennsylvania	2.10
7	Minnesota	8.50	24	West Virginia	6.50	41	Alaska	0
8	New Mexico	8.50	25	Utah	6.46	42	Connecticut	0
9	North Dakota	8.28	26	Massachusetts	6.25	43	Florida	0
10	Idaho	8.20	27	Georgia	6.00	44	Nevada	0
11	New York	7.88	28	Kentucky	6.00	45	New Hampshire	0
12	Delaware	7.70	29	Virginia	5.75	46	South Dakota	0
13	Montana	7.59	30	Kansas	5.15	47	Tennessee	0
14	Arkansas	7.00	31	Colorado	5.00	48	Texas	0
15	New Jersey	7.00	32	Maryland	5.00	49	Washington	0
16	North Carolina	7.00	33	Mississippi	5.00	50	Wyoming	0
17	Oklahoma	7.00	34	Michigan	4.60			

Local Income Taxes: Most states don't permit local income taxes, but they are a major factor in a few. Maryland counties and the City of Baltimore have piggyback taxes that are half of the state's tax. New York City's top bracket rate is 3.4%. The highest local tax is Philadelphia's at 4.96% for residents in all income brackets and 4.31% for commuters. Pittsburgh residents pay 2.875% while many smaller Pennsylvania communities have a 1% tax. Detroit has a 3% tax with smaller Michigan communities at 1%. One percent is also the rate in Birmingham, Kansas City, Newark, and St. Louis. Ohio municipalities have differing rates, mostly 2%. Kentucky allows a 2.2% tax in Louisville and Lexington. Portland (OR) has a rate under 1%.

Changes In Rates: In a year with almost no interest in state tax cuts, rates shown on Table 6 aren't likely to come down. Last year's interest in dropping Hawaii's highest-in-the-nation rate has been sapped by fiscal problems. So about the only rate-dropping prospects are in states with no sales tax that might sweeten adopting one with an income tax cut. This could happen sooner or later in Oregon, but property tax cuts get the first call on funds for tax relief.

Higher top bracket rates are on the standard list for public employee organizations seeking higher taxes to avoid spending cuts and to finance programs in which they are interested. Examples are California and New York, with governors and many legislators opposed in both places. In California, the budget proposal by legislative leadership (D) includes moving the top bracket rate to 11%. An increase in the top bracket rate was part of the governor's plan in Maryland, but was rejected by the legislature in favor of lower spending increases and confining tax change to minor adjustments. Although they haven't been proposed by governors, there is considerable interest in the legislatures in income tax increases in Kansas and Mississippi.

New Income Taxes: No state has adopted a personal income tax since New Jersey in the 1970s. There appears to be a stronger prospect of enactment in at least one state than anytime in the 1980s.

The governors of Connecticut and Tennessee are pushing new income taxes. The Connecticut proposal is being seriously debated, with extending the sales tax base the main alternative. All alternatives assume a mix of major spending cuts and a tax increase. The governor says he will veto any budget package that lacks an income tax. The Tennessee proposal is running into the predicable anti-tax opposition plus strong opposition from another quarter. The governor's plan links the tax with education reform, including switching from elected to appointed school superintendents. The powerful superintendents are seeking to block the package.

In Texas, an income tax is backed by powerful groups, but not the governor. Blue ribbon groups are looking at tax policy and spending levels, with debate over major tax issues unlikely until June. After rejecting one version, the Texas legislature has adopted a school finance equalization plan that increases the pressure for a major state tax increase of some sort.

New Hampshire's governor has said he would veto an income tax. In March, the House sent the leading income tax proposal back to committee by a 188-170 vote. There are several ways to interpret the vote: (1) the tax proposal didn't pass, (2) if it were to pass, the margin wouldn't be large enough to override a veto, and (3) a majority appears interested in the income tax alternative.

STUDYING HOW TO SAVE MONEY

Introduction: This is a big year for special studies of how to save money in state government. There is considerable reason to expect that few changes will result from them.

How The Studies Originate: Candidates for governor often promise they will do their best to cut the state budget. Because such promises are routine, they don't distinguish one candidate from another. So some candidates make more specific promises, such as cutting a specific amount. Governor Finney said she would trim $200 million from the Kansas budget. In his 1989 New Jersey campaign, Governor Florio promised major cuts before he would consider a tax increase.

After inauguration, especially this year, new governors are confronted with budget issues that don't seem to be framed to offer easy cuts. So they often turn to task forces or special studies. In New Jersey, tax increases were proposed and enacted before study results started to appear. In Kansas, the governor has proposed a major tax increase primarily for property tax relief, but promises proposals next year for cuts and a streamlining of state operations.

Studies also originate in the legislative branch. A major effort, labeled performance audits, is taking place in Texas this year. The idea is to use them to explore, and perhaps implement, ways to cut the budget to avoid a tax increase. Connecticut's commission was established coincident with a tax increase in 1989, showing that the legislature and governor were serious about spending cuts and not just relying on tax increases.

Systematic Problems With The Studies: The individuals called upon for these types of studies are typically auditors, accountants, management consultants, and loaned business executives. Their assigned mission is usually associated with concepts of improved management, efficiency, and modern management techniques. It is not normally associated with policy that may drive spending, such as whether states should provide aid to local government or provide free health care to the poor. But those conducting the studies are often asked to provide specific savings recommendations and dollar amounts to be saved. The pressures are on them to come up with big numbers for savings. The dilemma is whether to keep the recommendations narrow and within the expertise of those doing the study, at the expense of low dollar impact, or to make the recommendations broad, risking criticism as reflecting value judgments or, put another way, making political recommendations.

The Connecticut Study: The Connecticut study reflects the outcomes of such an effort. With a total budget of $4.4 million and a year and a half to do its work, the group had much more time and money available than do those conducting most such studies. It overspent its appropriation by about 10% and exceeded its scheduled duration by about 3%. Most of its work was contracted out, but it had an in-house staff loaned from the policy staffs of the legislature and the executive branch. The commission itself had 23 members, mostly appointed by legislative leaders and the governor. Its main report, Commission To Study The Management Of State Government: Final Report, contains the major recommendations. There are also interim and consultant reports.

Savings Claimed In Connecticut: The Connecticut budget is about $7 billion dollars. The recommended savings shown on the report's summary table are $578 million for FY 1992. The major dollar items are shown in Table 7.

Table 7: Connecticut Savings Recommendations, FY 1992 ($ millions)

Agency	Savings	Agency	Savings
Administrative Services	$111	University Health Center	$33
Higher Education	70	Child Support Enforcement	25
Public Works	60	Corrections	23
Revenue	59	Health Services	20

The savings are, with exceptions involving relatively small amounts, not the kind that could be reflected in lowered appropriations. The eight categories in Table 7 are assessed in the paragraphs below. The recommendations themselves are potentially applicable in all states. They also illustrate how difficult it is to translate such reports into budget decisions in a legislature.

Administrative Services: The big savings in administrative services come at the expense of employees through postponing a pay equity plan, making employees contribute more to the costs of their benefits, and altering the rules by which state employees collect Workers Compensation. A second component is increasing federal Medicaid reimbursement by obtaining certification of a children's facility and faster claims processing.

Higher Education: Extensive reorganization of higher education governance is recommended. But the largest savings appear to come from increases in tuition rates and more extensive tuition-earning use of facilities in the summer months. A $2.4 million savings in FY 1992 is expected from improvement in the higher education budgeting process.

Public Works: The largest saving in public works is selling surplus state property, followed by $21 million in savings from improving capital building and evaluation.

Revenue: The recommendations for the revenue agency are cost-increasing in its budget -- adding personnel, providing new laptop computers, converting to optical scanning, and more. The savings are increased collections led by $44 million from reducing the backlog of appeals.

University Health Center: The major savings recommendation, which was not adopted by the full commission, was to sell the hospital associated with the university, thereby saving in operating costs and avoiding new capital expenditures. The second largest item was increasing patient charges.

Child Support Enforcement: The report's savings are actually higher collections of child support enforcement money, which is estimated to come from more aggressive establishment of parentage, increased numbers of support order modifications, and greater use of wage withholding.

Corrections: Over half the corrections saving is from the recommendation to prevent an increase in the average time served per prisoner.

Health Services: The largest saving, nearly half the total, is a revenue increase by modifying the current fee schedule. The second largest saving is also a personnel item, $4.5 million at a children's hospital for "review employee retirement benefits."

Assessment Of Connecticut Cost-Savings: The fate of Connecticut budget issues is dependent upon legislative disposition of the governor's recommendation to adopt a new income tax. However, as a lengthy minority report by John Olsen (Connecticut AFL-CIO) points out, many of the commission recommendations are cost shifting. Many of the shifts are to local taxpayers, though local governments would have the option of reducing services (costs) in response to lower state aid allocations. The major dollar example is freezing aid allocations to cities and towns. The minor one is discontinuing what is known as the "resident state trooper" program, by which the state provides police work for small towns -- a service most states don't provide. There apparently is no dispute about the need for the service. So the issue isn't saving money, but which taxpayers, state or local, pay. Olsen cites other examples: (1) shifting to employees through sharing in health costs, (2) shifting to citizens by closing 10 of 18 motor vehicle branch offices forcing citizens to travel farther for licenses and titles, and (3) shifting costs to students through tuition.

New Jersey's Efforts: The major output of the New Jersey Management Review Commission was a reorganization proposal. It was assessed by the managing editor of the New Jersey Reporter (March/April) as being similar to an earlier effort of a prior governor and not necessarily offering cost savings:

> Much of what Florio proposed has been tried before in New Jersey and elsewhere, some of it repeatedly, and in many cases

> it has failed. Technical and political obstacles abound. And the administration appears to have made matters worse for itself by throwing up a few of its own. It is already apparent, for example, that the matter of budgetary savings -- cited at the outset as a major objective -- was oversold.
>
> "Governor Florio's goals in proposing these actions are to make government smaller, and, in the short and long run, to save the taxpayers' money," declared the proposed package's lead sentence. But the administration has been unable, despite repeated inquires, to back up that vague promise with even a general estimate. Moreover, since the opening bell, officials have sought to downplay the issue by suggesting they never meant to imply that reorganization by itself would produce a large pot of money.
>
> "The savings are not going to be overly generous," said {the executive director of the commission}. In fact, it is quite possible that reorganization -- depending on how it is designed and carried out -- could actually wind up costing taxpayers more, not less.

The Outlook: Attempts to find cost savings through special studies have had limited impacts on state budgets. This has been true for decades for: (1) the budget-oriented studies covered in this article, (2) the performance audits developed by state and outside auditors, and (3) the government-wide studies undertaken by business groups that have been parallel to the federal Grace Commission.

Many of the studies avoid major policy issues, such as employee pay levels or appropriate amounts of state aid to local government. When they do tackle subjects like these, they don't normally provide new information. For example, as Connecticut officials consider their fiscal crisis of 1991, they are considering recommendations of cutting employee pay by making employees pay more of their benefit costs, of cutting aid to local government, and of increasing university tuition. But these are options well known to officials of states without special commissions, and also known to Connecticut officials two years ago.

Such commissions do, from time to time, appear to impact the management of state operations, such as in internal organization of state activities, the management of operating functions such as license issuance, and the collection of taxes. While changes based on such recommendations may increase revenues, they normally don't provide dramatic reductions in spending.

This is not to imply that state spending can't be cut dramatically. It can be, and is being, cut in some states. But the big money decisions involved are fundamental policy choices that elected officials don't find much easier after reading reports than they did before.

STATE FINANCES

Fiscal Survey: The National Association of State Budget Officers has released its Fiscal Survey Of The States, reflecting the recommendations the governors made in their budgets. Many of the budgets were released in December and January, so the data don't reflect how bad the fiscal situation is currently perceived. For example, the stated budget gap in California has gone from under $8 billion in the governor's budget to over $12 billion in the governor's current estimate.

Summary Fiscal Indicators: The bad news appears in balances, expected revenues, and recommended spending. Balances at the end of FY 1991 are estimated to be 2.0% of spending and $1.5 billion lower than when the FY 1991 budgets were enacted last year. The FY 1992 end-of-year balances are expected to remain at about 2% of spending, well off the 5% that some observers consider a norm.

NASBO calculates that revenue increases of 6.3% are reflected in the FY 1992 budgets, including tax increases of $6.6 billion. {**Reports** predicts tax increases will exceed the $10.3 billion recorded last year by a substantial margin.} The spending increase in the FY 1992 governors' budgets is 4.8%. This would be the lowest rate of increase since FY 1983 when spending actually dropped according to the NASBO estimates.

Current Year Deficits: One of the ways of looking at the extent of fiscal pressure being faced by each of the states is the extent to which their governor's budget reflected a surplus or deficit for FY 1991. For this purpose, the household or federal definition of deficit is the relevant concept -- whether revenues exceeded spending. By state definitions a deficit occurs only if spending exceeds *the combination* of revenues *and balances brought into the year*. For example, Indiana's FY 1991 budget was well in balance by state terms with spending of $5.8 billion amply financed with resources of $5.9 billion. But the state used $300 million of balance drawdown, giving it a tight FY 1992 situation which may result in a freeze on school aid to avoid a tax increase. The surpluses or deficits of each state are shown on Table 8.

Only ten states expect to take in more revenue this year than they will spend. This result is plausible in states with recent tax increases, such as Kentucky and Oklahoma, or unexpected resource revenues, such as Alaska and North Dakota. It is less plausible for the other states, particularly Michigan and Massachusetts which has problems described later in this issue.

Table 8: Surplus Or Deficit In FY 1991 Budgets, Percent of Spending

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Alaska	23.5%	18	Arizona	-1.0%	34	Maine	-3.5%
2	Massachusetts	11.7	19	Florida	-1.0	35	Pennsylvania	-3.7
3	North Dakota	9.6	20	Colorado	-1.4	36	Ohio	-3.8
4	Michigan	4.1	21	North Carolina	-1.5	37	West Virginia	-4.1
5	Kentucky	2.2		**United States**	-1.5	38	Vermont	-4.6
6	New Hampshire	1.8	22	Rhode Island	-1.5	39	Kansas	-4.8
7	Oklahoma	1.3	23	Iowa	-1.7	40	Indiana	-5.1
8	Oregon	0.8	24	Alabama	-2.0	41	Minnesota	-5.3
9	South Dakota	0.4	25	Illinois	-2.1	42	Delaware	-5.5
10	South Carolina	0.2	26	Texas	-2.4	43	Montana	-5.7
11	Arkansas	0	27	New Mexico	-2.6	44	Louisiana	-5.9
12	New Jersey	0	28	Georgia	-2.7	45	Nevada	-6.2
13	New York	0	29	Idaho	-3.0	46	Nebraska	-6.2
14	Virginia	0	30	California	-3.1	47	Washington	-7.0
15	Missouri	-0.1	31	Tennessee	-3.1	48	Hawaii	-7.9
16	Mississippi	-0.2	32	Wisconsin	-3.1	49	Connecticut	-8.4
17	Maryland	-0.9	33	Utah	-3.4	50	Wyoming	-14.9

MISCELLANY

Block Grants: In his budget, the President proposed consolidation of about $20 billion of federal categorical grants into a block grant program with unspecified details. He invited state officials to work out details. In early April, Governor Campbell (SC) on behalf of the National Governors' Association and Speaker Martin (ME) on behalf of the National Conference of State Legislatures presented slightly differing proposals. An Administration spokesperson present at the press briefing indicated general agreement. Both proposals leave out locally oriented programs (e.g., subsidized housing and Community Development Block grants) included on the original Administration list.

Rapid action in the Congress isn't expected. For a plan to be ready for passage, details would have to be worked out to the satisfaction of state officials and the Administration. Then the plan would face probable opposition from some organizations of local officials and some of the interest groups closely identified with the individual categorical programs to be replaced.

Borrowing: State and local borrowing is highly concentrated. A few states, not necessarily the most populous, account for much of the direct state borrowing. Indirect borrowing through state authorities is much heavier by some states than others. Much the same pattern occurs for cities and school districts. Table 9 shows the jurisdictions that borrowed more than $300 million in FY 1990 *and* ranked among the top 40 public bond issuers identified by City & State (4/8).

Table 9: Top Public Bond Issuers in FY 1990 ($ millions)

Rank	Borrower	Amount	Rank	Borrower	Amount
1	New York City	$4,455	16	State of Illinois	$640
2	NY State Dormitory Auth.	3,341*	17	Mass. Industrial Fin. Auth.	640
3	Washington Power System	3,037*	18	NY Housing Finance Agency	613
4	State of Connecticut	2,954	19	State of Wisconsin	604
5	State of California	2,155	20	NY State Energy Auth.	555
6	City of Chicago	1,647	21	Alaska Housing Authority	517
7	NY City Transit Auth.	1,619	22	Mass. Transit Authority	495
8	State of Florida	1,240	23	State of New Jersey	483
9	State of Texas	1,099	24	Ohio Housing Agency	439
10	State of Massachusetts	1,068	25	California Housing Agency	423
11	Denver City and County	993	26	Suffolk County (NY)	377
12	NY Medical Fac. Agency	844	27	State of Pennsylvania	362
13	Mass. Water Resource Auth.	836	28	Washington, DC	351
14	Calif. Health Fac. Auth.	722	29	Orlando Utilities Comm.	332
15	Mass. Health & Educ. Auth.	682	30	State of Washington	306

* Includes Large Refinancing Of Existing Debt.

Of the 30 entities on the table, New York accounts for seven, including two of its local governments. Massachusetts, which ranks 13th in state population, accounts for five and California accounts for three.

Cross Subsidies: Most state subsidies to particular groups occur through the relatively public process of taking money by taxes and distributing it by appropriations. But considerable purchasing power is reallocated through state policy not involving these processes. Examples are hospital costs of the uninsured subsidized in hospital rates, utility costs of the poor in telephone and gas rates, and insurance costs of high risk drivers in auto insurance rates.

Sometimes, a state adopts a process by which the magnitude of these subsidies becomes known, often producing a strong public reaction. New Jersey's JUA charge and Pennsylvania's CAT fund charge in auto insurance were examples, both of which have been dropped. The latest example is the "Link Up Illinois" program. The program subsidized about $7 of the monthly phone bill of 60,000 low-income phone customers through a monthly 15 cent surcharge on other Illinois phone customers. The state utility commission dropped the program in March after it, and the administering phone companies, received thousands of objections.

Farm States: As usual, there are economic uncertainties associated with the agricultural economy. State officials in farm states worry about world market prices, the weather, and the vagaries of federal farm programs. While these factors can produce bad years, the fiscal condition of the farm states is currently better than most of the rest of the nation. There is no obvious definition of a "farm state." **Reports** related the Department of Agriculture's statistics on the value of farm crops to state population to produce Table 10. It shows relatively low direct reliance on farm sales in all but a few states.

Table 10: Per Capita Value of Farm Crops, 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	North Dakota	$3,276	18	Oklahoma	$365	34	Maine	$153
2	South Dakota	2,387	19	Oregon	365	35	Utah	149
3	Nebraska	2,325	20	Colorado	359	36	South Carolina	142
4	Iowa	2,088	21	California	355	37	Vermont	137
5	Idaho	1,723	22	Hawaii	347	38	Virginia	136
6	Montana	1,133		**United States**	**325**	39	Nevada	130
7	Kansas	1,108	23	North Carolina	297	40	Alabama	121
8	Minnesota	954	24	Louisiana	275	41	Pennsylvania	112
9	Arkansas	697	25	New Mexico	252	42	Maryland	83
10	Wyoming	659	26	Arizona	246	43	West Virginia	65
11	Indiana	538	27	Texas	246	44	New York	50
12	Illinois	505	28	Ohio	241	45	Connecticut	32
13	Washington	488	29	Delaware	210	46	New Hampshire	25
14	Kentucky	463	30	Florida	204	47	Massachusetts	23
15	Mississippi	439	31	Michigan	199	48	New Jersey	21
16	Missouri	405	32	Georgia	197	49	Rhode Island	5
17	Wisconsin	388	33	Tennessee	188	50	Alaska	4

Furloughs: Many of the previously announced state employee furloughs are not occurring. In Rhode Island, which attracted considerable national publicity for the plan for one-day shutdowns of state government, only a few shutdowns occurred. The others will be dropped in favor of a plan negotiated with labor organizations. Workers will not be paid for eight workdays from April through June and will lose pay for another 19 days in FY 1992. But the pay is just deferred, to be recouped as vacation time, personal days, or lump sum payments when the employees leave state service.

Local Government Finance: The Census Bureau recently issued its statistical compilations on local government finances in FY 1989. They show the sharp decline in federal aid for cities and counties over the last decade. The ten year development is shown in Table 11.

The declining importance of federal aid to cities and counties is one of the bases for local objections to the proposal for federal block grants for some of the remaining programs. The state aid shown by these Census statistics would probably decline more, except for two features of the federal statistics: (1) state education aid is counted as aid to cities or counties in the states without separate school districts and (2) in states with local administration of welfare and Medicaid, the increasing state spending counts as increased aid.

Table 11: Sources of City and County Revenue, Various Years

GOVERNMENT/Fiscal Year	Percentage of Revenue From: Federal	State	Local
COUNTY			
1979	10%	35%	55%
1985	5	30	65
1989	2	31	67
CITY			
1979	12	18	70
1985	7	16	77
1989	4	16	80

The Census statistics provide another way of looking at state-local relations in each state -- how much of the revenue-raising is handled by state governments. Nationally, states raise 55% of this revenue, but there are substantial differences among the states as shown on Table 12.

Table 12: Percent of State-Local Own-Source Revenue That Is State, FY 1989

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	82%	18	Washington	61%	35	Missouri	56%
2	Delaware	79%	19	Wisconsin	61%	36	Ohio	56%
3	Alaska	75%	20	Louisiana	61%		**United States**	**55%**
4	New Mexico	75%	21	Connecticut	60%	37	South Dakota	55%
5	West Virginia	69%	22	Utah	59%	38	Arizona	54%
6	North Dakota	67%	23	Indiana	59%	39	Nevada	54%
7	Arkansas	67%	24	Wyoming	58%	40	Tennessee	53%
8	Kentucky	66%	25	Mississippi	58%	41	Illinois	51%
9	Maine	66%	26	Iowa	58%	42	Oregon	51%
10	Rhode Island	66%	27	Maryland	58%	43	Kansas	50%
11	Vermont	66%	28	Virginia	58%	44	Nebraska	49%
12	Massachusetts	65%	29	Minnesota	57%	45	Florida	48%
13	South Carolina	64%	30	Montana	57%	46	Georgia	48%
14	Idaho	63%	31	Michigan	57%	47	Texas	47%
15	Alabama	62%	32	New Jersey	56%	48	Colorado	47%
16	North Carolina	62%	33	California	56%	49	New York	46%
17	Oklahoma	62%	34	Pennsylvania	56%	50	New Hampshire	44%

Legislative Staff Limits: The California Supreme Court has agreed to hear legislative challenges to Proposition 140 without waiting for lower court reviews. The proposition limits legislators' terms and cuts the legislative branch budget. Written arguments are due by May 1, with oral arguments to follow. Legislators are arguing, among other things, that the voter initiative upsets the constitutional balance between the legislature and other branches of state government.

Massachusetts Miracle: Financial difficulties continue to plague Massachusetts, which currently holds the lowest bond ratings in the nation. Revenue, adjusted for changes in tax law, hasn't been growing at all and is only expected to grow by 0.2% in FY 1992. Spending has been growing, particularly for social and health services. The FY 1991 budget was way out of balance, a problem only partly cured by legislation adopted earlier this year to cut spending and obtain one-time revenue gains.

Elected officials spent much of April dealing with the politically touchy issue of salaries. Concerned that the governor's plans would disproportionately single out lower paid employees, the legislature (D-majority) included language in the FY 1991 budget-balancing bill to reduce the $85,000 salaries of cabinet members. The governor (R) vetoed. The veto was sustained in a party-line vote in the Senate. Now the governor has proposed a 5% pay cut for everyone in state government making more than $60,000, which includes 1,835 state workers.

The state needs a large infusion of borrowed money in late June or early July to meet continuing obligations including a $1 billion payment to local governments. The treasurer wants an enacted FY 1992 budget before going to the rating agencies and bond markets, but some legislators doubt that the legislature can act that fast. As the House Ways and Means Chairman put it, the politics of dealing with nearly a $2 billion deficit in a budget of about $13-14 billion is frightening -- "It's frightening to Republicans. It's frightening to Democrats. It's frightening to liberals, and it's frightening to conservatives." The governor has been critical of legislators for not acting on some of his proposals. He told the Boston Globe (4/6):

> The important thing – is for the legislature to understand that they cannot sit around and play with their food until June 30 and then and only then start to deal with the '92 budget. If we do that, we are not going to be able to go to New York and borrow, and that means the June 30 local aid payment will not be made.

Pension Fund Administration: State pension fund administrators are having a mixed year. The good news is that the financial markets are performing well enough so that investment returns continue to swell assets and generally continue to exceed the returns assumed in the actuarial calculations used to determine employer and employee contributions. The bad news is that those assumed returns are being increased in many states, that costly pension benefit improvements continue to be enacted, and that the funds are being eyed as contributors to budget balancing plans. Special pension benefits for employees who retire early are one example. Delays of contributions are another. In Massachusetts, the governor is proposing to borrow from the plans to avoid added borrowing in the marketplace.

Texas Retirement System administrators drew the attention of the new state comptroller who introduced the "Silver Snout" award. He plans to award it monthly to state officials with "their noses buried deep in the public trough." TRS won the first award for $700,000 in spending on its headquarters including $235,000 for art, $8,800 for china, and $50,000 of equipment for its exercise room. Less dramatically, but with more at stake, Kansas elected officials are quizzing retirement system officials for losses of $65 million in savings and loans. The governor has appointed herself to the pension board in a move to restore confidence in the system.

Rhode Island Bailout? Faced with an estimated $150 million tab for bailout of state-regulated credit unions and other financial institutions closed earlier this year, Rhode Island officials are looking for the federal government to bail them out with a low interest loan. Chances aren't good. Most states didn't permit operation of such institutions without federal insurance as Rhode Island did. States that did permit them to operate both: (1) don't seem to have major losses and (2) are pushing their institutions into federal insurance. The precedents are state insured S&Ls, industrial banks, and other institutions where the states have covered the losses, including particularly large losses in Maryland, Nebraska, and Ohio. No federal assistance was provided in those cases.

Governor Sundlun and the state's senators got a rough reception from the Senate Banking Committee in mid-April. Senator Garn returned to the federal action on federally insured S&Ls, arguing that 74% of the cost was attributable to state-chartered and regulated institutions, suggested there was pressure for the Congress to end up holding the bag when actions of the state legislatures don't work out.

State Budgeting Practices: Political scientists Edward Clynch (Mississippi State U.) and Thomas Lauth (U. of Georgia) summarize 155 pages of analysis by 15 authors with: "As long as the American states operate with a governor and legislature independent of each other, power over budget decisions will ebb and flow between them." This may exhaust the interest of most readers in Governors, Legislatures, and Budgets: Diversity Across The American States (Greenwood, 1991). The book contains chapters with inconsistently comprehensive coverage of budget politics in the 1980s in California, Connecticut, Florida, Georgia, Idaho, Illinois, Kentucky, Minnesota, Mississippi, Ohio, South Carolina, Texas, and Utah.

Tax Increases: As state budget deliberations moved through April, the number of states likely to increase taxes and the aggregate amount of the increases continued to rise. Overall, revenue estimates are down and spending estimates are up. As a result, budget gaps are up also.

Not all the increases will occur on regular budget schedules. The sports phrase, "it isn't over till its over," may have particular relevance for state taxes. New York has already passed the beginning of its new fiscal year without acting on taxes. Texas has, in effect, rescheduled its budget session from the regular session in early 1991 until this summer. South Dakota's governor is already talking about a special session to reconsider the sales tax increase that was rejected in the regular session concluded earlier this year.

TECHNICAL NOTES

Balanced Tax System: The tables in the text deal separately with the big three (sales, property, and income) taxes and non-tax revenues. "Other" taxes are significant in some states. They include corporate franchise taxes, gambling taxes, severance taxes, and special levies such as utility and insurance taxes. Texas, for example, relies heavily on a franchise tax, rather than a corporate income tax. Oklahoma receives considerable revenue from severance taxes while Nevada gets much of its revenue from gambling taxes. Table A-1 (next page) provides a comparison of percentage reliance on all taxes.

Medicaid Reimbursements: The new fiscal survey quoted in the text was released in mid-April by the National Association of State Budget Officers (444 North Capitol St., NW, Washington, DC 20001). Elizabeth Kolbert, the New York Times Albany correspondent, used the quoted material as the lead paragraph in her April 14 story, "New York's Medicaid Costs Surge, But Health Care For The Poor Lags." The story suggests just how serious the state's problems have become. The state has about 10% of national Medicaid recipients, but about 20% of the nation's Medicaid costs. About 80% of the Medicaid home health care expenditures nationwide are in New York. While most American cities pay nothing for Medicaid, the New York City local contribution is about $1.6 billion.

The data shown in Tables 3 and 4 are from a recent report of the federal Physician Payment Review Commission. Robert Pear developed the assessment of the physician reimbursement issue for the New York Times (4/2&3). Comparisons of rates per unit of service presume the unit is defined the same from state to state, which is tricky. For example, a separately priced blood test may be common in one state, but not another, as a routine part of many office visits.

Table A-1: Sources of State And Local Tax Revenues, FY 1989

State	Property	Sales	Income	Other
Alabama	11%	50%	26%	11%
Alaska	32%	7%	22%	38%
Arizona	32%	45%	17%	5%
Arkansas	17%	47%	27%	7%
California	26%	33%	34%	6%
Colorado	35%	35%	24%	4%
Connecticut	40%	37%	15%	6%
Delaware	13%	11%	44%	29%
Florida	33%	53%	3%	9%
Georgia	27%	37%	31%	3%
Hawaii	13%	51%	31%	3%
Idaho	27%	36%	29%	5%
Illinois	35%	38%	21%	5%
Indiana	30%	38%	27%	3%
Iowa	35%	29%	27%	7%
Kansas	35%	33%	24%	6%
Kentucky	16%	37%	33%	12%
Louisiana	17%	51%	16%	15%
Maine	34%	32%	27%	5%
Maryland	24%	26%	40%	7%
Massachusetts	32%	22%	40%	4%
Michigan	38%	23%	32%	5%
Minnesota	30%	32%	31%	5%
Mississippi	24%	49%	17%	8%
Missouri	21%	43%	28%	6%
Montana	43%	14%	25%	16%
Nebraska	41%	32%	20%	5%
Nevada	21%	64%	0%	14%
New Hampshire	65%	15%	10%	8%
New Jersey	43%	28%	22%	5%
New Mexico	11%	53%	17%	17%
New York	30%	26%	36%	5%
North Carolina	20%	36%	36%	6%
North Dakota	29%	40%	15%	14%
Ohio	28%	32%	33%	5%
Oklahoma	18%	43%	22%	16%
Oregon	43%	9%	36%	9%
Pennsylvania	26%	30%	28%	13%
Rhode Island	38%	30%	26%	4%
South Carolina	24%	40%	29%	6%
South Dakota	41%	47%	2%	8%
Tennessee	22%	60%	7%	9%
Texas	39%	48%	0%	12%
Utah	29%	40%	25%	5%
Vermont	39%	29%	23%	7%
Virginia	29%	30%	30%	9%
Washington	28%	62%	0%	9%
West Virginia	17%	40%	27%	14%
Wisconsin	35%	28%	30%	4%
Wyoming	43%	25%	0%	31%
United States	**30%**	**35%**	**26%**	**7%**

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VOLUME 9 ISSUE 9

IN THIS ISSUE

State finances have been following the national economy in a downward spiral. The result is uncertainty about taxes and programs in most large states, increasing interest in "one-shot" measures, concern over defaults, and suggestions for better financial planning. California and New York are facing particularly difficult choices about the level of taxes and spending.

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Medicaid costs continue to rise rapidly, but some 35 million people remain without Medicaid, private insurance, or other health coverage. The prospects for federal or state action to control costs or expand insurance coverage are remote.

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Fiscal problems are finding their way into policies in many fields including dealing with the homeless and access to college.

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Texas officials have apparently solved one problem, school finance, only by creating another, big tax hikes.

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There is an abundance of new data and expert advice dealing with fiscal decisions.

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May 1991 (First of Two May Issues)

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THE STATE FISCAL CRISIS

Introduction: State fiscal problems are now dominating decisionmaking in practically every major field of state activity. Not every state is experiencing shortfalls, but 30 are, according to a recent survey. Those that aren't are generally smaller Western states. Even in states without major shortfalls, resources are tight enough to create major clashes over their use as indicated by a state employee strike in Montana and a teacher strike in Washington.

Timing Of Decisions: The fiscal policies of many states are unusually uncertain this year. In most years in most states, these decisions are predictable in the spring even if not made formally until later. This year, in many states, there is uncertainty about the magnitude of tax increases (or whether there will be increases), what taxes will be raised and, thus, what spending will be. The spending uncertainty means uncertainty about aid to local governments, tuition, employee pay, teacher pay, the extent of Medicaid coverage, Medicaid reimbursement rates, and the operating budgets of agencies.

The details are complex, but the overall problem is easily understood. Legislators don't want to vote for tax increases needed to sustain the spending they prefer and don't want to vote for spending cuts to fit with the level of taxes they are willing to support.

This uncertainty affects larger states including California, Massachusetts, Michigan, Minnesota, New York, Pennsylvania, Tennessee, and Texas. It affects some smaller ones such as Connecticut, Kansas, and Maine. In some of these cases, it is unlikely that legislatures will act before July 1. Some of the decision postponements are already clear. New York has passed the April 1 beginning of the fiscal year without decision. Texas legislative leaders and the governor have agreed to act on taxes and the budget in a July special session rather than the regular session. Tennessee seems to be on a schedule that will result in the showdown on the governor's proposed income tax in the fall rather than in the regular session. California's governor suggested the legislature make fiscal decisions before May 1 to permit spending and tax changes to be in effect for a longer period than possible if enactments were made on the usual schedule, about July first. But May 1 passed without decision.

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Economic Conditions: The National Bureau of Economic Research, the organization whose definition of recession is generally followed, has announced the nation is in a recession which began in July. The typical post-World War II recession has lasted 12 months. The longest were the 16 months of recession experienced in 1973-1975 and again in 1981-1982. Twelve months would make the recession completely congruent with FY 1991 in 46 states. Explicitly or implicitly, all of the state FY 1992 revenue estimates reflect a guess of when recession will end.

The Commerce Department late April GNP estimates indicated the nation has experienced two consecutive quarters of decline in real gross national product -- the shorthand definition of recession. The Commerce data confirm real GNP declines of 1.6% in the last quarter of 1990 and 2.8% in this year's first quarter.

An April survey by the National Conference of State Legislatures found total FY 1991 state budget shortfalls of $11.8 billion in the 30 states reporting shortfalls. This is more than was raised by state tax increases through legislative actions last year. To make it up, states would have to extract a one-time payment of about $100 from every worker in America.

Deficits were confirmed when the Commerce Department released the summary estimates of state and local finances that are a part of national GNP estimates. The deficit for all state and local governments (stated at an annual rate excluding retirement funds) was $44 billion in the fourth quarter of 1990. During the first three quarters, the deficit was about $30 billion while it was $20 billion for CY 1989.

According to the Commerce estimates, which are subject to revision, from CY 1989 to CY 1990, total state and local receipts increased 6.8%. Property taxes grew by 7.3%, more than other major taxes. Sales tax receipts were up 6.1%. Personal income tax revenue rose only 4.4%, while corporate income taxes declined.

Economic Growth: The Index of State Economic Momentum, which last appeared in Issue 6, is designed to show success in economic development and economic impacts on state fiscal condition by comparing each state to the national average. It can also be used to track a state's condition over time, though **Reports** hasn't stressed this use. The Providence Journal and Rhode Island Public Expenditure Council have been looking at Rhode Island's performance since the index began in early 1989. This stimulated the development of Table 1, which shows the rankings of selected states in March of 1989, February of 1990, and March of 1991, the latest index.

Table 1: Changing State Economic Momentum

State	Rank Among States			Index Number		
	1989	1990	1991	1989	1990	1991
Nevada	1	1	1	4.2	4.7	5.8
New Hampshire	2	42	50	2.2	-.8	-2.8
Florida	3	5	7	1.7	1.8	1.5
Washington	4	3	4	1.5	2.5	2.2
California	8	14	11	.9	.8	1.1
Massachusetts	18	45	48	.3	-1.2	-2.4
Georgia	20	26	23	.2	-.2	0
National Average	-	-	-	0	0	0
New Jersey	22	35	40	-.1	-.5	-1.1
Ohio	25	27	21	-.2	-.3	.1
New York	27	38	36	-.4	-.6	-.8
Pennsylvania	28	41	35	-.4	-.7	-.8
Illinois	34	30	43	-.7	-.3	-1.1
Texas	38	24	12	-.8	-.1	.8

State-By-State Summary: This section summarizes the major fiscal issues in the 13 largest states with 62% of the nation's population. Short summaries miss the nuances of hard-fought issues in each state, but give an impression of the magnitude of the difficulties these states face and what is, and isn't, being done.

Massachusetts remains in more trouble than any other state, as the bond rating agencies and State Budget & Tax News define trouble. Adjusted for changes in tax law, revenues are running below levels of a year earlier. Over the past year, there has been a 5.5% drop in employment in Massachusetts compared with a 1.2% drop nationwide. The new governor (R) is intent on no new taxes, several new tax reductions for business (which he has now decided not to push this year), and repealing the sales tax on services enacted last year, which he achieved earlier this year. His budget-balancing strategy places strong emphasis on one-shot items (see article in this issue) including indirect borrowing, selling assets, and deferring payments to an underfunded pension plan. Legislative leaders (D) are reluctant to accept some of the spending reductions being proposed, unhappy with some of the proposals for one-shot actions, and unwilling to propose tax increases in light of the governors opposition. No compromise is in sight. The impact of the cuts over the past several years has been highly concentrated on higher education and local governments, including elementary and secondary education.

Illinois, Michigan, and Ohio are in unusually good economic shape for a recession. The loss of jobs in Michigan and Ohio over the past year has been below the national average and Illinois has actually gained jobs over the past year. All three states have new Republican governors committed to no new taxes. All three have shortfalls in their current service budgets and required administrative cutbacks to keep the FY 1991 budgets near balance. Their legislatures, which have at least one Democratic-led house, are all considering budget recommendations from governors that cut back current social service programs. Decisions on these budgets won't be made until near the end of the fiscal year, June in Ohio and Illinois and September in Michigan. The pressure for a tax increase will be particularly strong in Michigan, where the current services budget is more out of balance than the other states. To avoid a tax increase, Michigan would need the kind of sharp cutting that may be in store for New Jersey. With an unpopular tax increase from last year, New Jersey elected officials are intent on avoiding a tax increase for any reason. They have already cut back the school aid increases adopted last year, but have considerable controversial cutting to go.

Georgia and Virginia budgets are already set. Virginia's previously enacted FY 1992 budget was cut back in the current legislative session. Most of the adjustments were relatively painless, like using lottery money for operating costs rather than for construction. Georgia profited from a court decision on how a partial food exemption was structured which allowed the legislature comfortably to forget the exemption. Some Florida and North Carolina officials would like to avoid major tax increases also, but will find it difficult to do so without depending upon major local option tax hikes.

Plenty of excitement is in store for those interested in tax policy in Pennsylvania and Texas. With the school finance decision described in this issue, Texas legislators have bought into whopping property tax increases (over $100 per capita) and an unbalanced state budget. They will debate the relative merits of broadening the sales tax base, enacting an income tax, and looking for a way to avoid either alternative. Pennsylvania legislators seem likely to conclude that both the state and local governments, particularly Philadelphia, need more money. A local option sales tax appears the solution for Philadelphia, but the state choice isn't clear. The governor's proposal avoids broad-based taxes by concentration on corporate income and miscellaneous taxes, such as on cigarettes.

National attention on state finances will probably center on California and New York. They are media centers, are the two largest states with 12% and 7.2% of the nation's population, have divided political party control, and present difficult but typical policy issues.

Both states have big budget gaps. In the NCSL shortfall survey, California reported a FY 1991 deficit of $3.6 billion or $121 per capita. This is well above the total for state governments nationwide of about $40-50 per capita, though not approaching the federal government with a deficit of about $1,000 per capita. New York's reported FY $1.15 billion current year shortfall is less, $64 per capita, but doesn't count $4 billion in annual borrowings. The FY 1992 budget gap numbers are even larger, $12-13 billion in California and around $4 billion in New York. These combine the current year shortfall, the gap between current service revenue and spending for FY 1992, and, in California's case, money to replenish reserves.

Governor Cuomo (D) and Governor Wilson (R) have both taken the position that spending is already at excessive levels, so that spending cuts must form a major part of closing the budget gap. Elementary and secondary education is a target. In New York, the governor has recommended a 10% cut and an even greater cut in non-school local aid. In California, Proposition 98 guarantees education the same percentage of the state budget as in the past, a guarantee Governor Wilson says shouldn't be honored. Both governors have recommended tight higher education budgets and substantial tuition increases. Governor Wilson wants cuts in cash benefit levels in welfare. Both governors want a variety of social and health service cuts.

Many legislators in both states are vocally uncomfortable with the proposed cuts. The most publicized concerns come from Democrats, who are in the majority in both bodies in California and the House in New York. But members of both parties recognize the considerable problem associated with outcomes that leave them accountable for raising taxes while cutting aid to schools and local government and not funding significant new initiatives of any kind.

Both governors have proposed tax increases. In California, the initial proposals concentrated on broadening the sales tax base, but the governor has now endorsed upping the sales tax rate. In New York, the cornerstone of the governor's tax plan is a ten-cent increase in the gas tax. Legislative leaders in the New York House and California Senate and House have been urging raising top bracket income tax rates and various other taxes, including many on business.

One-Shots: High reliance on one-time infusions of revenue to balance state budgets is drawing increasing critical comment. Such actions have always been criticized by bond rating agencies and financial experts. Spreading concern is evidenced by a Business Week (5/6) feature subtitled "How State And Local Budgeteers Are Gimmicking Their Way Out Of A Tight Squeeze."

Attention has been drawn in New York by the consistent criticism of the state comptroller, among others. In Massachusetts, where an extraordinary number of one-shot solutions have been used in the past, the newest round of proposals by the governor is being subjected to considerable denunciation in the legislature. Less noticed changes are appearing elsewhere, such as a proposed accounting change in California that forms a major part of the budget-balancing plans proposed by the governor. Business Week contends that Massachusetts, New Jersey, and New York "lead the pack in innovation." But, "also playing the game" are other states such as California, Illinois, and Michigan.

The prime examples: (1) selling state facilities to a state authority and then renting them back (New York) or avoiding rent by having costs recovered in tolls (New Jersey and New York), (2) borrowing money to cover a short term shortfall and paying it back over a long period (Massachusetts), (3) juggling the payback schedules of existing bonds (Massachusetts, proposed), (4) accelerating tax collections (many states), (5) delaying scheduled payments (many states with Illinois a recent example and West Virginia an older one), (6) short-term loans to the general fund from other funds (many states with Texas probably holding the record for the amount involved). These devices aren't new, just being used much more this year.

One new to **Reports** is a practice **Business Week** says is being used by Michigan school districts -- the use of zero coupon bonds without a sinking fund. This means that the entire principal and accumulated interest for a facility comes due as a lump sum 20-30 years after the bonds are issued. The practice would be in violation of state law in most states

One-Shot Solutions: The essence of budgetary one-shots is that they trade a current improvement in finances for a worse outlook for the future. Most one-shots aren't complicated. Selling New York's Attica prison and leasing it back has the same impact as selling your paid-for personal car and then leasing it or a comparable car. Covering past Massachusetts deficits by borrowing is like deciding to cover a bad year by running up the balance on credit card debt. The economics doesn't change when the loan is from the industrial finance authority, which in turn borrows in the marketplace, as proposed by Pennsylvania's governor. The immediate financial improvement is clear, as is the negative impact on the future.

Critics of one-shots have urged that states engage in some sort of financial planning that forces consideration of the negative impacts in future years along with the positive impacts in the budget year. This is one of the arguments for switching from annual to biennial budgets. It is also an argument for maintaining some sort of five or ten year plan.

This concept of a longer time horizon for state decisions is the subject of the new Journal Of State Government (Jan-Mar.). Keon Chi (Council of State Governments) assesses state futures commissions. There have been 31 of these since 1970 with titles like the Oregon 2000 Commission and Commission on the Future of South Carolina. He likes the idea of these groups and expects more use of them in the future. But, "One lesson we can learn from this overview of state foresight projects is that unless state leaders themselves are willing to change the way they make decisions, no guarantees exist that such projects will work." Former Mississippi Governor William Winter concludes: "There must be a willingness on the part of officials to put the long-term public interest ahead of personal political safety." He suggests that this is the best way to restore trust in the political system.

While taking the long view isn't required in many state governments, it is by state-mandated local planning processes in effect in about a fourth of the states. Many of these processes, like those in Florida and Maine, are well along in the local decisionmaking phases. New Jersey's has reached the stage where a state plan will be released after a review and comment stage called "cross acceptance."

The Moratorium On New Initiatives: One result of state fiscal problems is the almost complete absence of major initiatives involving general fund money. This is illustrated by the list of significant initiatives shown in Table 2. Lacking an agreed definition of "new initiatives" or "major," any listing of major new initiatives is arbitrary. **Reports** may have left out one or two major initiatives through ignorance of details of discussions in every state and left out some low cost initiatives, but the overwhelming impression is that new initiatives aren't in the cards in most states. Where they are, the initiatives using general fund money are raising some tax to lower another or funding for education reform.

Table 2: Major New Initiatives Being Considered For FY 1992

State	Initiative	Status
Alaska	Infrastructure, Econ. Development	Pending
Arkansas	Education Quality	Passed
Connecticut	Tax Reform	Pending
Kansas	Education Finance and Tax Reform	Pending
Missouri	Education Quality	Pending
South Dakota	Education Quality	Defeated
Tennessee	Education Quality and Tax Reform	Pending
Texas	School Finance Equalization	Passed

New initiatives not involving general fund money are much more common. Examples are air and water pollution control measures financed by regulatory fees, transportation and other infrastructure projects financed by issuing bonds, and solid waste disposal plans with financing from user charges.

Consent Decrees: As elected officials look for ways to cut state spending patterns, they are constantly encountering consent decrees entered into by their predecessors. One of many examples is provided by Massachusetts. Buffeted by all kinds of fiscal problems and with the lowest bond rating in the nation, the state has a new governor committed to no tax increases. With a shortfall that is as much as 20% of tax revenues, he sees a need for spending cuts such as limits on overtime, closing institutions, layoffs, reductions in payments to vendors, and more. The governor has been pursuing all these alternatives with substantial support in the legislature.

With many people adversely affected, there has been litigation and the threat of litigation in many areas. One major setback to the budget cuts developed in late April when a federal district judge ruled that the state would have to comply with the terms of a consent decree entered into with mental retardation groups 16 years ago. Among other things, the decree requires the state to negotiate any changes of policy (e.g., staffing, payments to providers) with those groups and submit the results for court approval.

Defaults By States? In Forbes (4/29), William Tucker explores, "Is There Such A Thing As Municipal Junk?" He quotes a variety of experts as seeing no default risk associated with municipal bonds of the states and major cities. But he finds others that express some concerns including: (1) uncertainty over whether municipal bond insurers could handle several defaults at once and (2) replacement of cooperative local commercial banks with arms-length mutual funds as the primary purchasers in the tax-exempt bond market.

Statewide Strikes: Roughly 25,000 teachers in Washington State went on strike in late April, closing many schools including those in Seattle and Tacoma. The issue is pending state legislation, specifically the biennial budget. The state doesn't prescribe salaries but provides most of the money spent by local schools and discusses the budget in terms of the salaries it could finance. The governor's proposal was for 4.4%, then 3.8% in the two years of the biennium. The teachers want at least 10%. House and Senate versions of the budget legislation offer slightly less than the governor's version. The teachers are also concerned about the decline in the share of the state budget for education, school construction, textbook and supplies funding, and other issues. Many of the teachers have no-strike clauses in their contracts, but these may not be enforced because some administrators are believed to be in sympathy with the teachers.

Many Montana state employees are operating under a two-year contract that includes the right to strike during the last six months of the contract, a period that began in January. In April, an estimated 5,000 state workers, out of about 14,000, exercised this right. The issue was a 60-cent an hour pay raise that had passed the legislature, was vetoed by the governor, and (the precipitating event) not overridden by the House. The governor favors a pay plan that provides larger raises for professional, higher paid employees rather than a uniform amount for all workers. State facilities remained open, with the National Guard providing some of the staffing at prisons and other state institutions. A compromise on pay ended the walkout.

PAYING FOR HEALTH CARE

State Health Insurance Plans: Former Governor Dukakis is now a visiting professor at the University of Hawaii. In that capacity he recently shared his insights on health care with the editors of the Honolulu Star-Bulletin (3/24). He complemented Hawaii for its unique universal health care law. Because it was passed in the 1970s, it benefits from an exemption from federal law (Employee Retirement Income Security Act) that permits the state to mandate that employers provide coverage. Other states can't mandate coverage, so their proposals rely on taxing employers who fail to provide coverage. Dukakis was a major force in the adoption of the first-on-the-mainland plan in 1988, but its major provisions haven't been implemented. The legislature has been pushing back the effective date. Dukakis told the paper that state-by-state action on universal care isn't the answer on the mainland because of interstate rivalry. He recalled that whenever Massachusetts passed a law providing social benefits, New Hampshire's governor used it to seek to draw businesses to the Granite State.

According to State Health Notes, this is a big year for consideration of state universal health care plans. The publication says at lest 14 states "are debating or, at the very least, studying such plans." This is up from last year when the publication counted such activity in only two states. These conclusions may be true in terms of bills offered, hearings held, and expenditures of time and money by health care providers and other interested parties in talking about the subject. It is emphatically not true in terms of possibilities that any such plans will be enacted.

The plans are running into objections on the merits, which might or might not be sufficient to kill them. They are also running into fiscal problems which might be sufficient to kill them even if there were no objections on the merits.

All the serious plans require new money at the table: (1) taxes on employers to require them to provide coverage or pay for state provision of coverage and (2) state tax money. **Reports** knows of no state where there is serious consideration of either method. The efforts farthest along were Massachusetts (enacted but deferred), Maine (demonstration likely to be deferred), and New Jersey (where support of reasonably united organized labor, many business leaders, health care providers, and state officials wasn't enough).

Who Lacks Health Insurance? There are roughly 34 million Americans who lacked health coverage from private insurance or public programs in 1989. This is 16% of nonelderly Americans. That 16% is up from 12% in 1978, indicating that public policy *has not* reduced the uninsured segment of the population. Of the uninsured, 54.6% were adults with jobs (often with small firms or self employed), 16.7% were adults without jobs, and 28.7% were children. The state-by-state data appear in Table 3.

The table reports what people said about their health coverage in the past year when they were surveyed in early 1990. Because of deteriorating economic conditions since then, the percentage without health coverage today is undoubtedly larger.

Table 3: Percentage of Nonelderly Population Without Health Coverage

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Iowa	8.6%	18	New Jersey	12.3%	34	Idaho	17.6%
2	Michigan	9.7	19	South Dakota	13.1	35	Georgia	17.8
3	Massachusetts	10.0	20	Missouri	13.8	36	Nevada	17.8
4	Hawaii	10.1	21	Washington	13.9	37	South Carolina	17.8
5	Ohio	10.3	22	New York	14.1	38	Delaware	18.2
6	Connecticut	10.4	22	Virginia	14.1	39	Alabama	19.4
6	Utah	10.4	24	Wyoming	14.4	40	Arkansas	20.2
8	Minnesota	10.6	25	Indiana	14.7	41	Mississippi	20.2
9	North Dakota	10.8	26	New Hampshire	15.1	42	Louisiana	20.3
9	Pennsylvania	10.8	27	Tennessee	15.3	43	Arizona	20.7
9	Wisconsin	10.8	28	Kentucky	15.9	44	Florida	21.4
12	Maine	11.0		**United States**	**16.1**	45	California	21.9
13	Kansas	11.3	29	Oregon	16.2	46	Alaska	22.2
14	Illinois	11.5	30	Colorado	16.5	47	Oklahoma	23.8
15	Rhode Island	11.8	31	West Virginia	17.0	48	New Mexico	24.7
16	Maryland	12.0	32	Montana	17.2	49	Texas	25.5
17	Nebraska	12.3	32	North Carolina	17.2	50	Vermont	n.a

The uncovered population in Table 3 counts persons as covered if they were entitled to health services through any public or private coverage. Medicaid coverage reduces the uncovered population shown, just as private coverage does. As a result, there isn't a perfect correlation between the percentage of a state's population that is poor and the percentage that doesn't have health coverage. The percentage of nonelderly reporting Medicaid coverage is shown on Table 4.

Table 4: Percentage of Nonelderly Population With Medicaid Coverage

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Mississippi	14.6%	17	Kentucky	8.6%	34	Nebraska	6.3%
2	Michigan	12.6	17	Pennsylvania	8.6	34	Oklahoma	6.3
3	Louisiana	12.4	19	Georgia	8.1	34	Oregon	6.3
4	California	11.8	20	Ohio	8.0	34	Utah	6.3
5	New York	11.7	21	Rhode Island	7.8	34	Wisconsin	6.3
6	South Dakota	10.3	22	Colorado	7.7	39	New Jersey	6.2
7	Tennessee	10.0	23	Virginia	7.6	40	Iowa	5.6
8	West Virginia	9.7	24	Washington	7.3	40	North Carolina	5.6
9	Alabama	9.6	25	Arizona	7.2	42	Nevada	5.5
10	Illinois	9.5	26	Kansas	7.1	43	Connecticut	2.0
11	Montana	9.4	27	Florida	7.0	44	Alaska	n.a
12	Maine	9.0	28	Minnesota	6.9	45	Delaware	n.a
12	Missouri	9.0	28	South Carolina	6.9	46	Idaho	n.a
14	Massachusetts	8.9	30	Texas	6.8	47	North Dakota	n.a
14	New Mexico	8.9	31	Hawaii	6.7	48	Vermont	n.a
16	Arkansas	8.7	31	Indiana	6.7	49	Wyoming	n.a
	United States	**8.7**	33	Maryland	6.5	50	New Hampshire	n.a

The percentage coverage is an interaction of the generosity of the Medicaid program and the percentage of the population that is low income. Mississippi makes the top of the list on the second point while Michigan makes second place primarily on the first aspect.

THE HOMELESS

The Homeless: The Census Bureau is under attack for a possible undercount of the population in the 1990 Census. The criticism was particularly sharp when the Bureau announced that it had counted 228,621 homeless, an estimate that falls far short of some advocacy group estimates of millions. Not surprisingly, the argument is primarily over the roughly 50,000 said to be on the streets rather than the nearly 200,000 in shelters. Of the total homeless, the largest numbers were counted in California (48,887) and New York (43,204) with no other state having more than 10,000. Relating the counts to population produces the results shown in Table 5.

Table 5: Number Of Homeless Per 10,000 Population, 1990

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Mississippi	1.8	18	Tennessee	4.5	35	Pennsylvania	7.8
2	Arkansas	2.3	19	Alabama	4.7	36	Florida	7.9
3	West Virginia	2.7	20	Virginia	4.8	37	Illinois	8.0
4	South Carolina	3.1	21	North Dakota	4.8	38	Oklahoma	8.1
5	Wisconsin	3.3	22	Missouri	4.8	39	Colorado	8.9
6	Maine	3.4	23	Nebraska	4.9		**United States**	**9.0**
7	New Hampshire	3.4	24	Delaware	5.0	40	Alaska	9.5
8	Iowa	4.1	25	Rhode Island	5.1	41	Washington	10.8
9	Ohio	4.1	26	Idaho	5.3	42	Massachusetts	11.4
10	Louisiana	4.1	27	Texas	5.4	43	New Jersey	11.8
11	Wyoming	4.3	28	Minnesota	5.4	44	Nevada	12.0
12	Kentucky	4.3	29	New Mexico	5.5	45	Arizona	12.6
13	Michigan	4.3	30	Montana	5.7	46	Oregon	13.4
14	North Carolina	4.3	31	Maryland	6.3	47	Connecticut	13.4
15	Vermont	4.4	32	South Dakota	6.7	48	California	16.4
16	Kansas	4.4	33	Georgia	6.7	49	Hawaii	17.3
17	Indiana	4.5	34	Utah	7.0	50	New York	23.9

The states that have been the most active in committing state funds for housing programs and dealing with the homeless have been those hardest hit by current fiscal difficulties. Those programs are facing budget reductions in the entire Northeast. For example, the Connecticut budget would eliminate the state's practice of subsidizing the operating costs of nonprofit housing groups. The Massachusetts fiscal plan would cut off the state's operating subsidy program.

TUITION SETTING

Tuition Increases: In their budgets, many governors have used higher tuition as a mechanism for seeking to balance budgets without raising taxes or cutting back spending. In most states, these recommendations are leading to tuition increases without much controversy in the legislature or the academic world. For example, both houses of the Florida legislature have adopted 10% increases in state university tuition, to $1,300 a year.

Tuition Controversies: The exceptions, however, are significant. In New York, student protests have closed down the City University of New York (CUNY) at several locations. The policy approach in New York was: (1) no tuition increase for about five years, (2) a planned tuition increase in 1989 that was rescinded after student protest, (3) a small increase adopted uneventfully in 1990, and (4) the proposed large increase creating controversy now. This scenario undoubtedly made the increases this year more controversial than they would have been if small annual increases had been used.

In California, there have been tuition increases assumed in each of the last several budgets. In national terms these are small in amount, but large in percentage because California tuition has historically been low -- low enough to be called fees, not tuition, for many years. In Massachusetts, the impact of state budget circumstances on higher education has probably been greater than anywhere else. Tuition will likely have doubled within a four year period before FY 1992 is over.

Tuition As A Budget Balance Wheel: These states illustrate the tendency for state tuition policy to be "jerky," with changing state financial circumstances reflected in allocations to higher education and tuition. When times are good, tuition increases are low or avoided entirely. When times are bad, tuition rockets up as state officials use it as a balancing entry in their budgets. This tendency appeared in the early 1980s, when tuition rose rapidly, and then increased less rapidly late in the decade.

Tuition Formulas: To avoid this, a recent study shows that 16 states use some sort of a formula for setting tuition. The most common pattern is to establish a policy that tuition cover a stipulated percentage (generally 20-35%) of instructional costs. The study concludes that such systems are "neither a panacea or a scourge." They don't seem to drive tuitions higher or lower than they would otherwise be. They don't always guarantee stability, because states can abandon them in a pinch, as Massachusetts is doing.

Out-Of-State Tuition: Fiscal pressures have renewed legislative interest in out-of-state tuition. When state aid levels are set, it is in university administrator's interest to maximize out-of-state students. They provide substantially more tuition income than in-state students, while costing the same amount to educate. In reaction, many states have formal or informal limits on such students. In Florida, the guideline has been 10%, but universities have been running at 11%. The tuition legislation approved by both houses operates in another way, raising the tuition by 24% to $5,700.

Current Tuition Levels: Table 6 illustrates the ranges in state policies on tuition by showing the 1990-1991 academic year in-state tuition for selected state institutions and the extra tuition required from out-of-state residents.

Table 6: FY 1991 Tuition At Selected State Institutions

Institution	Tuition	Out-of-State Surcharge
California State (Fullerton)	$952	$6,150
U. of Texas (Austin)	1,020	3,120
U. of North Carolina (Chapel Hill)	1,059	4,709
U. of Florida	1,322	3,300
City U. of New York (Hunter C.)	1,342	2,800
State U. of New York (Albany)	1,485	3,350
U. of Arizona	1,540	5,006
U. of California (Berkeley)	1,640	5,916
U. of Alabama (Huntsville)	2,019	2,019
U. of Mississippi	2,059	1,182
U. of Colorado (Boulder)	2,097	6,512
Ohio State U.	2,343	4,599
U. of Illinois (Champaign-Urbana)	2,846	3,540
U. of Massachusetts (Amherst)	3,476	4,853
U. of Michigan (Ann Arbor)	3,502	8,508
U. of New Hampshire	3,558	6,080
Pennsylvania State U.	4,048	4,396
U. of Vermont	4,590	8,600

Differing state policies are apparent from the table. California has relatively low tuition for residents, but doesn't share its low tuition policy with non-residents. Institutions with a large potential draw of out-of-state students, like Colorado and Michigan, are expensive for non-residents. But Alabama and Mississippi have relatively low non-resident surcharges. Vermont has high tuition and a high surcharge.

TEXAS SCHOOL FINANCE

Texas School Finance: In mid-April, after several false starts, the Texas legislature passed, and Governor Richards signed, a new school finance law. Legislators were under the gun to reform the existing system which was declared unconstitutional by the state's supreme court. The local judge with jurisdiction over implementation of the court's decision was perceived as likely to cut off all state aid after April 15 if the legislature didn't act. Presented with the new legislation, he agreed not to suspend aid distribution, but did not decide on the constitutionality of the legislation.

The legislation responds to the court's decision that unconstitutional discrimination was involved when students were in districts of unequal wealth and state aid failed to offset the inequalities. In substance, it spreads the property tax wealth, making the poor richer and the rich poorer.

The school bill will provide whopping tax increases in some Texas communities. It mandates a tax rate of 0.72% this fall, which will rise to 1% the following year. The yield of this tax will be given to 188 new taxing units. Their primary function is to create the substance of a statewide property tax -- equalizing wealth among over 1,000 districts -- without violating a constitutional prohibition against such a tax. All districts will be guaranteed a foundation spending level of $2,800 in the second year of the program. In addition, districts can levy additional taxes of 0.45% of value and be guaranteed $21.50 per pupil for each 0.01%, with state aid supplementing the local revenues to achieve this result. More affluent districts will have a strong incentive to levy this amount to maintain current spending patterns. Less affluent ones will have a strong incentive because their state cost sharing will be high. On top of these two tiers of state aid, local districts can levy additional taxes without state equalization payments.

Projections by the state education department, which were not available until after the bill passed, indicated that local taxes would increase by $2.1 billion statewide in the first two years of implementation. This would be $123 per capita, considerably more than estimates when the legislation was passed. At time of passage it was understood that precise cost estimates weren't available, but one figure used for property tax effect was $400 million.

The poorer districts haven't decided on whether to contest the school aid formula further. From a pure equalization perspective, it has a weakness in funding differences above the 1.45% tax level, which the legislature mitigated with a spending cap for rich districts, and in financing school construction. But the result already is strongly equalizing and very expensive. So poor districts may opt to skip further controversy over the formula for now and let attention focus on paying for it. The new school legislation seems to make a state tax increase inevitable. As the Speaker put it, "We're going to have to have some kind of tax bill."

The regular session is expected to end without action on taxes or the budget. There will be a special session in July to consider the budget for the biennium which begins in September. That budget will require substantial new revenue to make the school finance plan work and cover what would have been a gap even without it. By July, there will be special studies of spending (performance audits) available from the Legislative Budget Board and a tax policy report from a blue ribbon commission. In addition to the lieutenant governor's income tax proposal, the Speaker has offered a proposal for raising the sales tax, broadening the sales tax base to services including professional services, and adopting a corporate (but not personal) income tax. The governor is still keeping her options open.

STATE AND LOCAL FINANCE

Arizona Study: The Arizona Fiscal 2000 project was a comprehensive blue ribbon assessment of state fiscal issues based in part on papers prepared by prominent experts throughout the nation. The technical papers were recently published by the School of Public Affairs, Arizona State University (Tempe, AZ 85287) as State And Local Finance For The 1990s: A Case Study Of Arizona. The 483-page volume is heavily oriented to specific conditions in Arizona. This limits its usefulness because some Arizona characteristics -- such as rapid population growth, a health care system that makes it technically the only state without Medicaid, and a small number of strong county governments -- are relatively unique. The chapters most useful to other states are the ones on taxation, many by nationally known experts.

In one chapter, Robert Carroll (U.S. Treasury Department) and Michael Wasylenko (Syracuse U.) find essentially no discernable relationship between state tax policy or state spending and employment growth. They conclude this is because state policies differ little from one state to another. However, they suggest these policies would matter "if a state gets far out-of-line on either taxes or expenditures."

Gold On Balancing Budgets: During the 1980s, Steven Gold served as a fiscal expert for the National Conference of State Legislatures -- traveling coast to coast presenting expert testimony to legislatures and writing prolifically on tax matters with volumes like The State Fiscal Agenda For The 1990s (NCSL, 1990). As NCSL staff, he was precluded from taking sides in individual state controversies. His shift to the State University of New York removed this constraint and created some demand for him to apply his expertise to the Empire State's fiscal problems. So what is he telling New Yorkers to do?

He sees the fiscal problems of state and local governments as permanent phenomena of the 1990s, not temporary ones of 1991. He says many states, including New York, have structural deficits -- "meaning that the spending needed to maintain the current level of services will exceed revenue from the existing tax structure on a continuing basis." He suggests a multi-year plan encompassing both state and local governments.

State-local spending in New York is "bloated" and should be brought down from 45-50% higher per capita than the national average to 25-30%. He finds much of the overspending to be local and proposes reducing state mandates, streamlining local government structure, and overhauling state aid programs that stimulate local spending. Gold is comfortable with Governor Cuomo's proposals for cutting state revenue sharing and school aid. Gold comments, "It is much more vital to have a commitment to restructuring that it is to be generous with school budgets." He also endorses closing some mental hospitals in favor of community programs and raising tuition while increasing scholarships. To stem the rise of corrections costs, he likes revisiting some of the sentencing reform decisions that have caused increased prison spending.

On taxes, Gold warns against tax decisions strongly opposed by business because of the impact on economic development. He suggests the revenue raising priority be extension of the sales tax to exempt consumer purchases like non prescription drugs, cable TV, hair care, and dry-cleaning. He rejects further broadening of the sales tax base: "I reject taxing business and professional services because of the fragility of the New York economy; it would be better if another state with a stronger economy, like Florida or California, were to become the first industrial state to have a broad service tax." As a temporary measure, in addition to the base-broadening, he suggests a sales tax rate increase combined with an income tax credit for low income persons to offset the regressivity of the sales tax.

In testimony before the U.S. House Ways and Means Committee (4/17), Gold suggested that many states have structural deficits. He predicted that "states will be increasing taxes in the 1990s," resulting in an increase in the percentage of personal income taken by state and local taxes and user charges. He characterized this prediction as "controversial." Even with the increases, he told the committee, which was inquiring into state solutions for national health care problems, that "the states cannot solve this problem by themselves."

While suggesting higher taxes, Gold is apparently willing to defend one-shot fiscal solutions. The Business Week article on one-shots (see lead article) closes its commentary with a comment from Gold: "It's normal and reasonable to use gimmicks in a temporary tight spot. It's just not good to use them year in and year out."

Bahl On State Tax Policy: While Gold moved from Colorado to New York, Roy Bahl moved from New York (Syracuse U.) to Georgia (Georgia State). Bahl has written extensively on state and local finances and has been involved in tax studies in many states. He published his prescriptions for Georgia in the Atlanta Constitution (4/14). He argues that the economy has changed from a time when consumers spent primarily for commodities, earnings were mostly wages and salaries, and real property was a greater proportion of individual wealth. The shift has left some portions of the economy undertaxed relative to the others.

He suggests that the tax system include services under the sales tax. He would minimize the difference in tax burdens on real property and intangible personal property (like stocks and bonds). For business income, he proposes eliminating the corporate income tax and reaching all business activity (whether corporate or not, whether profitable or not) with a value added tax. He would eliminate business tax incentives -- seeking lower rates for all businesses, not just for a few. The only tax breaks for the elderly would be means-tested, "While some of the elderly are truly disadvantaged and must be protected, the average retiree has an income that's higher than the average worker."

To start Georgia's reform, Bahl recommends a blue ribbon commission.

Tax Burdens: The Rhode Island Public Expenditure Council (300 Richmond St., Providence, RI 02903) compiles a handy pocket-sized set of tables ranking all 50 states called How Rhode Island Compares. It includes per capita and percent of personal income information for personal income taxes, sales taxes, and property taxes for FY 1989, reflecting data recently issued by the Census Bureau. Besides these standard items there are two different tables. One turns the personal income table upside down by reporting the percentage of personal income remaining after state and local taxes. This makes New Hampshire first rather than last and Alaska last rather than first.

The other unique table arrays taxes as a percentage of personal income for each year from FY 1985 through FY 1989, permitting easy consideration of changes. Nationally, there was essentially no change. State and local taxes were 11.58% of income in FY 1985 and 11.56% in FY 1989. (This percentage could rise sharply for FY 1991, reflecting slow income growth.) From FY 1985 to FY 1989, these are the more significant changes:

- Alaska and Wyoming reduced tax burdens, reflecting lower resource prices and thus tax revenues. Alaska stayed the highest tax state but Wyoming ceded second place to New York.

- Hawaii's burden increased from 12.8% of income to 14.6%, moving to fourth from ninth. Maine increased from 12.4% to 13.3%, moving from twelfth to sixth. Slight increases in New Mexico and Arizona moved them into the top ten, with ranks of eight and nine.

- Others in the latest top ten were Minnesota (fifth, formerly fourth), Wisconsin (seventh in both years), and Oregon (from thirteenth to tenth).

- In ranks from eleventh through 40th, the tax burdens differ little, from 12.3 to 10.7%. So there are many rank changes based upon small changes in tax burdens. The larger rank changes are Iowa (29th to 14th), Washington (22 to 15), Nebraska (41 to 19), Utah (8 to 22), West Virginia (14 to 25), Massachusetts (18 to 28), Pennsylvania (24 to 39), and Nevada (25 to 38).

- There was little change in the bottom ranks -- the states with the lowest tax burdens by this measure.

Statistical Compilations: Several compilations repackage information on finances, primarily data from federal reports like Government Finances in 1989.

The Tax Foundation's Facts And Figures On Government Finance: 1991 Edition (Johns Hopkins Press) is 359 pages of information on finances at all levels of government. The virtues of the publication are its length, and thus coverage, and the extensive use of historical tables. The weakness stems from the time it takes to produce a book of its length in hardback binding. The data stop with what was available in the Government Finances series for 1988. Anyone needing the latest data would have to supplement the volume with another source.

The Advisory Commission on Intergovernmental Relations (1111 20th St., N.W., Washington, DC 20575) Significant Features Of Fiscal Federalism deals with the problem of current data by splitting into two volumes. Volume 1, which has already been issued for 1991, is primarily a description of federal, state, and local tax systems (e.g., rates, base) in 1990. Its 174 pages of this information make it an excellent source for most such comparisons. Volume 2 will cover financial statistics like tax burdens and spending comparisons. It will appear later this year.

The new States In Profile should be arriving in subscribers' offices soon after they get this issue of **Reports.** *{Subscribers who have opted for a subscription without the twice-yearly Profile and full service subscribers who want to buy extra copies should call the subscription office.}*

Is State Spending Meeting "Need"? ACIR has also issued its long (115-page) version of Representative Expenditures: Addressing The Neglected Dimension Of Fiscal Capacity. The concept is to compare spending needs of the states by setting as a benchmark the average spending of all states relative to workload (e.g., spending per student). This gives a higher need measure to states with high workload measures, such as large numbers of pupils in relation to population. ACIR's calculations of need, using FY 1987 data, have been available for several years. They tend to show the least need in states with low percentages of population in poverty and few students (e.g., Connecticut) and the most in states with the reverse (e.g., Mississippi). States with high need would, other things being equal, have to spend more per capita than low need states to provide equal public services.

The new material in the report includes: (1) the detailed documentation of how the estimates were derived, (2) complex calculations which purport to permit adjustment of spending estimates for cost differences among states, and (3) extensive tables relating measures of need to actual spending levels and to measures of tax-raising ability using several criteria for tax capacity of the states. The impact of federal grants on capacity is also estimated. However, in providing all this methodological sophistication, ACIR didn't update the underlying numbers, which are for FY 1987.

Comparing States In Meeting "Need": The demographic and economic characteristics of states change slowly enough so that ACIR's basic conclusions remain appropriate for comparing states showing major differences. Table 7 shows the key information for selected states. The first column is the per capita "gap" between what a state would raise with average state and local tax policy and what it would spend with average state and local spending patterns. Nationally, there is no gap because the average taxes finance the average spending. For example, Mississippi could match the national average tax system and come up $1,298 per capita short of matching national spending averages. To maintain balanced budgets, some combination of below average spending and above average tax rates would be necessary. Conversely, Connecticut could match national average spending and taxes and have $1,274 left over for lower taxes and/or higher spending. These amounts can be expressed as percentages, which is done in the report. For example, the gap in Mississippi is 43% of the estimated spending while the advantage enjoyed by Connecticut is about 52%.

Table 7: Per Capita Gaps Between Spending Need And Revenue-Raising Capacity Of Selected States, FY 1987

State	Per Capita	Percent	State	Per Capita	Percent
Mississippi	$1,298	43%	**United States**	$0	0%
Alabama	900	31	Pennsylvania	49	2
Michigan	351	12	Florida	-322	-13
Texas	283	10	New York	342	13
North Carolina	244	9	California	-424	-16
Ohio	239	9	Massachusetts	-1,062	-45
Nebraska	152	6	Alaska	-1,269	-39
Illinois	137	5	Connecticut	-1,274	-52

Table 7 can be viewed as pricing a national equalization system equivalent to school finance equalization being undertaken in the states. The federal government could put all states on the same fiscal footing by taxing the amounts shown as minus numbers and distributing the proceeds in the amounts shown as plus numbers. With a less "Robin Hood" approach, it could simply make aid payments equal to the plus numbers. This plan would cost about $50 billion.

Budget And Tax Reform: In Florida, as elsewhere, there is continuing dissatisfaction with the state's budget process and the tax system. One response was voter approval of a 1988 constitutional amendment creating the Florida Taxation and Budget Reform Commission (251 Holland Bldg, P. O. Box 20869, Tallahassee, FL 32316) which recently issued its first report, A Program For Reform Of Florida Government. The group is a blue ribbon commission with members appointed by the governor and legislative leaders. Its 92-page report focuses on recommendations for budgeting rather than tax policy, though there are recommendations on local option taxes and tax administration.

The report addresses such subjects as the timing of legislative consideration of appropriations, the format of the appropriations bill, the extent of the line-item veto authority, rainy day funds, use of generally accepted accounting principles, agency authority to make transfers among appropriations, executive branch reorganization flexibility, and performance monitoring.

Intangibles Taxes: The use of taxes on intangible assets (e.g., stocks, bonds, copyrights) is addressed by an article by John Bowman and his Virginia Commonwealth U. colleagues in the National Tax Journal (12/90). The article reflects a 50-state survey of intangibles tax policies. The typical pattern is to consider income from such items as a basis of income tax liability, but not have a separate tax, a trend accentuated in the 1980s. Separate intangibles taxes now raise about $1.5 billion for state and local governments. Most of this is in states with no personal income tax -- Connecticut, Florida, New Hampshire, and Tennessee. Other significant users of what they call a "flawed tax" are Georgia, Kentucky, Louisiana, Michigan, North Carolina, Pennsylvania, and West Virginia. They list arguments against the separate intangibles tax, suggest states look elsewhere for revenue, and conclude, "The decline in the role of intangibles taxation has not been without reason."

MISCELLANY

Intergovernmental Relations Commissions: The U.S. Advisory Commission on Intergovernmental Relations is comprised of representatives of state, local, and federal governments. Its mission is making the federal system work better. In the 1970s, it recommended each state establish comparable entities. By its most recent inventory, State-Local Relations Organizations: The ACIR Counterparts, it counts 26 states with such organizations. Six are different organizational models, legislative commissions and local panels advising the governor. The budgets of the 26 vary from zero to over $1 million. Permanent staffs vary from none to 19. The publication provides details on the organizations in each state and an assessment of their impacts.

Desegregation Litigation: The Supreme Court's Brown v. Board of Education case eliminating segregation in public schools is now 37 years old. While nearly two generations of students have now gone through school systems that were not segregated (in the sense of not admitting blacks to white schools or whites to black schools), litigation continues at the elementary and secondary and university level. Some of it has major cost implications for some states.

The higher education case arises in Mississippi, but affects states that at one time maintained separate colleges and universities. Mississippi long ago stopped discriminating in the usual sense. As the U.S. Fifth Circuit Court of Appeals put it last year in a 9-4 decision, the state "satisfies its constitutional obligation by discontinuing prior discriminatory practices and adopting and implementing good-faith, race-neutral policies and procedures." The issue arises because some of the traditionally black schools are inferior to some of the traditionally white schools. The state's argument is that basically this doesn't matter so long as blacks are free to attend the traditionally white schools and do so in substantial numbers and whites attend the traditionally black schools. The alternative view is that, parallel to the situation in elementary and secondary education, the state must make additional investments in the traditionally black schools. The U.S. Supreme Court recently decided to take the companion cases (U.S. v. Mabus and Ayers v. Mabus) with argument likely this fall.

Pension Plan Investments: Adventurous investment policies by some state pension plans have been in the news lately. Most states limit the audacity, and thus riskiness, of pension fund management by prudence rules similar to those the states impose upon other trustees (e.g. charity boards, trustees of estates). Some states apply these rules to most pension fund investments but use a "basket clause" that authorizes retirement system administrators to invest a small percentage of fund assets outside those limitations. Often this authority isn't used, or is used to make investments that are conservative, such as mortgage-backed securities. But the riskier the investment, the higher the rate of return tends to be from a long-term perspective. So some retirement systems are making more aggressive investments with a part of their portfolios.

One is the Kansas Public Employees Retirement System which has been buying securities through private placements and investing in local enterprises. The result has been an estimated $118 million in losses, including a $65 million loss in Home Savings Association, a failed S&L. With 12% of its funds in real estate, the fund is also at risk from investments like shopping malls in Kansas, an industrial park in Dallas, and an office park in Phoenix. The fund trustees have placed a moratorium on similar investments. Several investigations are underway. In a move she said was to restore confidence in the board, the governor appointed herself as a trustee, an appointment that is subject to Senate confirmation. There is no allegation of criminal conduct, but the losses are triggering a reassessment of how elected officials monitor administration of the plan.

The Virginia Retirement System made national financial news (Wall Street Journal, 4/26) by a decision to risk up to 5% of its assets in commodities futures trading. The system also engages in short sales (selling something it doesn't own).

Population Counts: The Census Bureau's 1990 population counts drive allocation of Congressional and legislative seats, allocation of federal and state grants, and many comparisons (e.g., per capita taxes) that affect policy. But the counts are imperfect, with the issue being whether the imperfections can be quantified accurately enough to make adjustments. In late April, the Bureau released alternative estimates.

For the nation, the count produced 248.7 million people. By going back and checking selected areas (post-enumeration surveys), Census researchers concluded the right number is between 253 and 255 million. By a separate demographic analysis using birth, death and other information, researchers concluded the right answer lies between 252.8 million and 257 million. The next move will be a Census decision by July 15 on what count to certify. The Census Bureau could conclude, as it did after the 1980 Census, that adjusted figures would be more inaccurate than the original ones.

Potential adjustments wouldn't have equal impacts. The largest upward revisions are likely to be in central cities. From the post-enumeration methodology, even with the low end of the estimated ranges, no state count would be reduced by more than 2% with the largest adjustments in Pennsylvania, Kentucky, and the New England states. Using the top end of the range, there could be upward adjustments of over 4% in Arizona, California, Delaware, Florida, Georgia, Maryland, New Mexico, North Carolina, South Carolina, Virginia, and West Virginia.

TECHNICAL NOTES

Health Coverage; The data on uninsured persons and Medicaid coverage are from the Employee Benefits Research Institute (2121 K St., NW, Washington, DC 20037), Uninsured In The United States. The results are based on the March 199[illegible] Current Population Survey, which means they report what coverage persons interviewed thought they had. The survey sample was too small for estimates to be made for some of the smallest states Estimates for many less populous states are subject to some sampling error. Because of these factors, the Medicaid coverage reported on Table 4 may not be identical to that reported from other sources. Only the nonelderly are included because persons over 65 have Medicare coverage. A good summary of the characteristics of the uninsured is combined with an assessment of the prospects for controlling health costs in Rising Health Care Costs: Causes, Implications, And Strategies (Congressional Budget Office, 1991)

Tuition Setting: The study is Tuition Formulas At Work: An Examination of States That Use A Numerical Formula To Help Set College Tuition (Lawrence Gold for American Association of State Colleges and Universities). The tuition data come from the College Board (Box 886, New York, New York 10101) The College Cost Book, 1991. The data do not include adjustments made in the second semester by some institutions subjected to mid-year budget cutting by state governments.

State And Local Finance: The representative expenditure data presented in Table 7 use the representative tax system measure of fiscal capacity not taking into account federal aid. It uses the representative expenditure system definition of need, adjusting for price level differences.

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IN THIS ISSUE

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Growing public school enrollments haven't been a major source of fiscal pressures on states. This is likely to change somewhat in the 1990s, but eleven states are predicted to have fewer pupils in 2000 than in 1990.

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State finances are looking worse. Revenues are falling below expectations. The many barriers to cost-cutting are being discovered. A record year for tax increases appears increasingly likely.

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May 1991 (Second of Two May Issues)

FEDERAL IMPACTS ON STATE ECONOMIES

Introduction: The federal government's impact on state economies is massive by just about any measure. Federal taxes and spending account for 20-25% of gross national product, with the exact amount dependent on the budget concept and year used for measurement. Over the 1980s, federal grants to state and local governments declined in relative significance, while federal payments of Social Security and Medicare increased substantially in real terms.

Considerable state effort is devoted to influencing the location of federal economic impacts. States compete to encourage the location of some facilities, like new research installations, and attempt to maximize federal grant allocations. With the recession killing off all but a few major new private installation construction decisions, federal decisions can seem like virtually the only game in town for economic development.

Overall Federal Impacts: The federal spending decisions affecting states reflect purchasing power of about $4,000 per capita nationally. The impact of these decisions differs considerably among states as shown in Table 1.

The range of deviations from the national average runs from Virginia with $1,900 more federal spending per capita to North Carolina with $931 less. This means that North Carolina lost out on $6.2 billion of purchasing power it could have had by being at the national average. This represents on the order of 200,000 jobs if each $30,000 represents about one job. Conversely, Virginia got about $11.8 billion of "extra" federal spending, or nearly 400,000 jobs.

Ten states had federal impacts 10% or more above the national average. Fifteen states were 10% or more below the national average. There isn't much consistent regional variation in federal impacts. The Southeast has the top state (Virginia) and the bottom one (North Carolina). New England has two states (Connecticut and Massachusetts) in the top ten, but two (New Hampshire and Vermont) in the bottom ten. Western states do better than average, but there are exceptions like Nevada and Oregon. Midwestern states are consistently poor performers in attracting federal dollars.

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Table 1: Per Capita Federal Impacts, FY 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Virginia	$5,874	18	Maine	$4,011	34	Iowa	$3,587
2	Alaska	5,867		**United States**	**3,974**	35	Louisiana	3,582
3	New Mexico	5,703	19	Florida	3,970	36	Arkansas	3,509
4	Maryland	5,671	20	South Carolina	3,919	37	Ohio	3,496
5	Massachusetts	4,949	21	New York	3,918	38	Oregon	3,457
6	Hawaii	4,927	22	Mississippi	3,912	39	Nevada	3,448
7	Missouri	4,741	23	California	3,891	40	Minnesota	3,445
8	North Dakota	4,555	24	Idaho	3,862	41	Texas	3,428
9	Connecticut	4,484	25	Nebraska	3,860	42	Georgia	3,265
10	Colorado	4,428	26	Kansas	3,850	43	Delaware	3,226
11	Rhode Island	4,303	27	Pennsylvania	3,823	44	Illinois	3,210
12	Alabama	4,272	28	Utah	3,779	45	New Hampshire	3,209
13	Montana	4,186	29	Oklahoma	3,753	46	Vermont	3,148
14	Washington	4,140	30	Tennessee	3,701	47	Michigan	3,142
15	South Dakota	4,114	31	West Virginia	3,685	48	Wisconsin	3,052
16	Arizona	4,112	32	Kentucky	3,670	49	Indiana	3,051
17	Wyoming	4,089	33	New Jersey	3,664	50	North Carolina	3,043

Summarizing Federal Impacts: The total federal spending on which this article is based was just over a trillion dollars in FY 1990. The total excludes amounts spent abroad, interest payments on the federal debt, and certain other categories of spending where allocation among states was not practicable or meaningful. Most of the federal impact on state economies comes through direct federal activities, not grants to state and local governments, as shown in Table 2.

Table 2: Distribution Of Federal Funds, FY 1990

Category	Amount (billions)	Percent
Direct Payments For Individuals	$498	49.6%
Procurement	188	18.8
Salaries And Wages	146	14.6
Grants To State And Local Government	134	13.4
Other	36	3.6
Total	$1,003	100.0%

The following text and tables analyze how individual states are doing in these major components of federal financial impact. The same information is summarized for each state in the Technical Notes.

FEDERAL GRANT PROGRAMS

Per capita federal grants are most significantly influenced by the AFDC (welfare) and Medicaid programs. Broad eligibility criteria, high welfare grant levels, and high reimbursement rates for providers all tend to make these programs expensive, and thus make the federal as well as state share high in per capita terms. This explains the high rankings of states like New York, Rhode Island, and Massachusetts in Table 3.

Table 3: Per Capita Federal Grants To State and Local Government, FY 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$1,303	18	Tennessee	$557	34	Utah	$487
2	Wyoming	1,253	19	Kentucky	555	35	Georgia	484
3	New York	876	20	South Carolina	542	36	Delaware	470
4	Rhode Island	770	21	Minnesota	541	37	California	468
5	Montana	740	22	Hawaii	540	38	Iowa	464
6	North Dakota	737		**United States**	533	39	Illinois	462
7	South Dakota	734	23	Arkansas	532	40	North Carolina	444
8	Vermont	670	24	Washington	528	41	Arizona	442
9	Massachusetts	641	25	Alabama	520	42	Indiana	437
10	New Mexico	633	26	Wisconsin	519	43	Colorado	434
11	Louisiana	630	27	Pennsylvania	515	44	Missouri	425
12	Maine	621	28	New Jersey	514	45	Kansas	412
13	Mississippi	620	29	Michigan	511	46	Texas	406
14	Oregon	601	30	Oklahoma	498	47	New Hampshire	385
15	Connecticut	600	31	Ohio	497	48	Nevada	368
16	Idaho	565	32	Nebraska	494	49	Virginia	361
17	West Virginia	562	33	Maryland	491	50	Florida	354

Sparsely populated Western states rank high in per capita aid for several reasons. First, like all small states, they benefit from minimum grants in some programs. Second, they receive funds as shared revenue from uses of the public lands like mineral leasing, grazing, and timber operations. Third, they benefit from programs oriented toward Native Americans. The recipe for being on the bottom of Table 3 is to have none of these characteristics and have relatively austere welfare and Medicaid programs.

FEDERAL JOBS AND PURCHASING

Wages And Salaries: Some federal salaries, such as those of postal workers, are fairly evenly distributed throughout the country. Others are concentrated at federal installations, particularly military bases. The resulting distribution is shown in Table 4.

Table 4: Per Capita Federal Wage And Salary Payments, FY 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$2,249	18	Nebraska	$603	34	Louisiana	$442
2	Hawaii	1,954	19	California	596	35	Massachusetts	440
3	Virginia	1,665	20	Kansas	591	36	New Jersey	439
4	Maryland	1,276		**United States**	**579**	37	Pennsylvania	433
5	New Mexico	897	21	Delaware	576	38	Oregon	417
6	Colorado	837	22	Arizona	558	39	Illinois	416
7	Utah	828	23	Missouri	558	40	Arkansas	396
8	North Dakota	800	24	Rhode Island	556	41	Connecticut	385
9	Washington	736	25	North Carolina	538	42	Vermont	373
10	Oklahoma	725	26	Nevada	537	43	Ohio	362
11	South Dakota	722	27	Texas	533	44	New York	357
12	Wyoming	694	28	Kentucky	521	45	West Virginia	335
13	South Carolina	690	29	Florida	510	46	Indiana	325
14	Georgia	683	30	Idaho	505	47	Minnesota	308
15	Alabama	682	31	Mississippi	500	48	Iowa	264
16	Montana	654	32	Maine	457	49	Michigan	262
17	New Hampshire	624	33	Tennessee	456	50	Wisconsin	245

A high concentration of workers associated with public lands and military installations makes Alaska first, followed by Hawaii because of military bases, and the two states (Maryland and Virginia) bordering Washington, DC. States at the bottom of the list have few or no significant military installations or major civilian facilities like research laboratories.

Procurement: Procurement spending, which is primarily military, is shown in Table 5 (next page). The range of federal impacts is very wide -- from over $2,100 in New Mexico to a low of under $200 per capita in five states.

New Mexico leads the list because of procurement activities associated with atomic energy and nuclear weapons. Government contractors around Washington, DC and other military and civilian contractors account for Maryland and Virginia rankings. Massachusetts (Raytheon), Missouri (McDonnell Douglas), and Connecticut (United Technologies) have well-known large military contractors as well as many smaller ones.

FEDERAL PAYMENTS FOR INDIVIDUALS

Direct Payments For Individuals: In FY 1990, the federal government spent almost $1,000 per capita in Social Security payments and nearly $450 per capita in Medicare benefits. This enormous and growing purchasing power is distributed among the states by decisions of the retirees on where to live.

Table 5: Per Capita Federal Procurement Spending, FY 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	New Mexico	$2,149	17	Nevada	$690	34	Georgia	$344
2	Virginia	1,643	18	Tennessee	678	35	Wyoming	322
3	Massachusetts	1,464	19	Texas	660	36	Oklahoma	278
4	Maryland	1,400	20	Mississippi	628	37	Nebraska	270
5	Missouri	1,360	21	Rhode Island	598	38	Wisconsin	258
6	Connecticut	1,352	22	Louisiana	565	39	North Dakota	256
7	Colorado	1,227	23	New Jersey	557	40	Iowa	252
8	Arizona	1,001	24	Ohio	557	41	North Carolina	240
9	California	991	25	Kentucky	545	42	Oregon	228
10	Alaska	962	26	Florida	511	43	Illinois	228
11	Utah	896	27	Hawaii	494	44	Montana	209
12	Idaho	856	28	New York	479	45	Delaware	208
13	Alabama	839	29	Minnesota	475	46	Vermont	190
14	Washington	810	30	Kansas	457	47	Michigan	183
15	Maine	767	31	New Hampshire	388	48	West Virginia	181
16	South Carolina	764	32	Indiana	356	49	South Dakota	171
	United States	**747**	33	Pennsylvania	350	50	Arkansas	166

Social Security, Medicare, and the retirement benefits of former federal workers constitute the bulk of the money covered in Table 6. The amounts also include such other direct payments as Food Stamps ($55 per capita) and Pell grants for college students ($17 per capita).

Table 6: Per Capita Federal Direct Payments, FY 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Florida	$2,541	18	Kansas	$2,043	34	Hawaii	$1,835
2	West Virginia	2,494	19	Mississippi	2,041	35	Vermont	1,821
3	Pennsylvania	2,425	20	Virginia	2,024	36	Louisiana	1,817
4	Rhode Island	2,283	21	Arizona	2,014	37	Nevada	1,811
5	Arkansas	2,249	22	Ohio	2,008	38	Indiana	1,808
6	Massachusetts	2,203	23	North Dakota	1,999	39	Idaho	1,790
7	Alabama	2,126	24	Nebraska	1,993	40	South Carolina	1,777
8	Michigan	2,116	25	South Dakota	1,990	41	North Carolina	1,741
9	Missouri	2,109	26	Illinois	1,985	42	New Hampshire	1,735
10	New Jersey	2,105		**United States**	**1,973**	43	California	1,729
11	Oregon	2,097	27	Kentucky	1,972	44	Colorado	1,726
12	Maine	2,090	28	Connecticut	1,967	45	Minnesota	1,724
13	New York	2,090	29	Tennessee	1,942	46	Texas	1,699
14	Oklahoma	2,076	30	Washington	1,917	47	Wyoming	1,698
15	Montana	2,057	31	Wisconsin	1,916	48	Georgia	1,673
16	Iowa	2,054	32	Delaware	1,905	49	Utah	1,446
17	Maryland	2,053	33	New Mexico	1,882	50	Alaska	1,113

Retirees tend to stay where they lived when they worked. This accounts for the high per capita numbers for states like Pennsylvania and West Virginia. Their population hasn't grown much overall, so retirees constitute a larger proportion of the population. States that have grown rapidly in recent years have fewer retirees in relation to population and rank low in Table 6. Also ranking high are retirement destination states like Florida and Arkansas.

"FAIRNESS" OF FEDERAL IMPACTS

Equity In Federal Impacts: The equity aspects of the distribution of federal purchasing power among the states are parallel to the equity aspects of distributing state funds among communities. There are three basic, and conflicting, logics involved:

(1) Returning money to the areas where it was raised.

(2) Distributing money in proportion to "need" as indicated by the logics of individual programs, such as putting education funds where students are and funds for defense purchases where the qualified contractors are.

(3) Distributing money pursuant to a development logic that concentrates operating funding in areas with least local fiscal capacity and infrastructure in areas that are the least developed economically.

While each of these philosophies is argued for federal policy, there is no overriding federal logic for fund distribution. Instead, decisions in each program are considered separately from the others. The data presented in this article show the results after the fact, not a considered policy before the fact. That is, there never was a federal decision for FY 1990 that Virginia should get more and North Carolina less. The individual decisions reflect all three logics, sometimes together. For example, highway funds are distributed largely on the basis of where the federal gas tax moneys are raised. Spending for Social Security, Indians, and disadvantaged children goes where those individuals are found. With the near demise of federal economic development programs, little money is distributed with a development rationale. However, the rationale motivates, to some degree, decisions on federal facilities expansions and closings. The distribution of some federal aid, like Food Stamps, follows a national standard of need. But the distribution of Medicaid tends to favor states with high fiscal capacity that can afford the matching requirements.

Where Federal Money Is Raised: The federal tax system is highly dependent on income-based taxes -- the federal personal income tax and Social Security payroll taxes. As a result, there is a close correlation between per capita federal taxes and per capita income.

The new estimates of per capita income for 1990 released by the Commerce Department appear in Table 7.

Table 7: Per Capita Personal Income, 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Connecticut	$25,358		**United States**	**$18,685**	34	Arizona	$16,297
2	New Jersey	24,968	18	Pennsylvania	18,672	35	North Carolina	16,203
3	Massachusetts	22,642	19	Florida	18,586	36	South Dakota	15,872
4	New York	21,975	20	Michigan	18,346	37	Tennessee	15,798
5	Maryland	21,864	21	Kansas	17,986	38	Oklahoma	15,444
6	Alaska	21,761	22	Wisconsin	17,503	39	North Dakota	15,255
7	California	20,795	23	Missouri	17,497	40	Idaho	15,160
8	New Hampshire	20,789	24	Ohio	17,473	41	Montana	15,110
9	Illinois	20,303	25	Vermont	17,436	42	South Carolina	15,099
10	Hawaii	20,254	26	Iowa	17,249	43	Kentucky	14,929
11	Delaware	20,039	27	Nebraska	17,221	44	Alabama	14,826
12	Virginia	19,746	28	Maine	17,200	45	Louisiana	14,391
13	Nevada	19,416	29	Oregon	17,156	46	New Mexico	14,228
14	Washington	18,858	30	Georgia	16,944	47	Arkansas	14,218
15	Rhode Island	18,841	31	Indiana	16,864	48	Utah	14,083
16	Colorado	18,794	32	Texas	16,759	49	West Virginia	13,747
17	Minnesota	18,731	33	Wyoming	16,398	50	Mississippi	12,735

State rankings in per capita income tend to be relatively stable over time. One key to being near the top is to have high wage and salary rates to drive up the numerator of the calculation. Another key is to avoid having large numbers of children and retirees in relation to the working population, as they drive up the denominator. The patterns of personal income tend to be reflected in each state's share of federal taxes (States In Profile, Table F-13) and in per capita federal income tax liability (Profile, Table F-7). Per capita income taxes on CY 1988 income were $1,755 nationally. Connecticut was over $3,000 followed by New Jersey, Massachusetts, Nevada, and New Hampshire. Those states did not rank high in the per capita federal spending shown in Table 1.

Terms Of Trade: It is possible to relate any single element of federal spending in a state to the tax payments from that state to calculate "terms of trade." The implicit assumption is that 100% of tax payments that finance spending should be returned as spending in the state where the federal taxes were collected. This doesn't happen in federal grants to states for the same reasons it doesn't happen in state grants to local governments. Need, as defined by grant formulas, doesn't coincide with ability to pay as defined by the tax system. The terms of trade (Profile, Table F-2) are shown for illustrative states in Table 8.

Table 8: Terms of Trade With Washington
Selected States, FY 1990 ($ million)

State	Grants	Taxes	Difference	Return*
Mississippi	$1,595	$810	$785	197%
Alaska	717	382	335	188
New York	15,761	11,957	3,804	132
California	13,932	17,783	-3,851	78
Illinois	5,280	7,075	-1795	75
New Jersey	3,977	6,196	-2,219	64

* Percentage of taxes returned as grants.

Federal Spending And "Need": If federal spending were oriented toward indicators of comparative "need" in the states, vastly different federal distributions would occur. This would be true with just about any indicator of need. For example, the two top states in fiscal capacity, Alaska and Wyoming, would not be in that position in per capita federal grants.

There are many different ways to measure "need" and many different types of federal spending to consider. For the sake of illustration, Table 9 uses low per capita income (Table 7) as a need indicator and compares this need ranking with rankings in some of the other tables shown in this article. If federal policies were oriented to providing aid to states with the least fiscal capacity and/or lowest incomes, assistance would be concentrated on states with the top need ranks. The table suggests that this isn't the case.

Table 9: State Ranks in "Need" and Per Capita Federal Spending

Need		Federal Spending Ranks			
Rank	State	Total	Grants	Wages	Procurement
1	Mississippi	22	13	31	20
2	West Virginia	31	17	45	48
3	Utah	28	34	7	11
48	Massachusetts	5	9	35	3
49	New Jersey	33	28	36	23
50	Connecticut	9	15	41	6

The Outlook And State Strategies: State officials and Congressional delegations sometimes act as though they have a goal of maximizing federal spending in their states. This means, in effect, trying to improve the rankings on Table 1 by improving amounts that make up that total as shown on the other tables. To this end, they seek more favorable treatment for their states in grant formulas and discretionary grants and seek location of federal facilities of most types. Within states, there are efforts to help business, particularly small business, participate in federal procurement. Likewise, in some states there is increasing concern over where an affluent retired population goes. While attracting retirees is often the focus, a quantitatively important factor is how many retirees can be induced to stay in places like the Northeast and Midwest.

State officials have sought to keep federal installations by avoiding closings and to encourage continued purchases from their defense contractors. Competition is hot in many of these areas. In procurement, there are constant geographically oriented battles in the Congress. These involve whether certain weapons shall be purchased at all as well as the mix of weapons systems for particular applications, such as Navy fighter aircraft. Other battles involve the selection of contractors, such as the choice of a Connecticut versus Virginia location for procurement of a new Navy submarine. States and state Congressional delegations also are involved in issues over which bases should be closed and which should be expanded.

Besides trying to attract contracts, states try to attract contractors from other states. For example, in arguing that California isn't doing enough to keep aerospace jobs, two consultants recently (2/26) expressed concern in an OpEd in the Sacramento Bee about Missouri courting Lockheed, Georgia wooing Hughes, and Utah offering financial incentives to McDonnell Douglas. They note, "States like Oklahoma have offices in Los Angeles whose sole purpose is to raid our aerospace markets and take the business home."

During the 1990s, the rankings in Table 1 will change automatically and substantially as the distribution of federal spending changes. Current federal budget projections and other indications of the likely direction in federal policy suggest a dramatic change in the mix of federal policy. Direct payments to individuals will increase their share of the total with rising Social Security benefits (which escalate with inflation) and Medicare outlays (which rise automatically with health costs and consumption) for an increasing number of retired persons. This will help the rankings of Arizona, Florida, and other retirement destinations as well as Northeastern and Midwestern states. On current plans, the role of military procurement and pay will drop, adversely affecting the position of states with major military bases and defense contractors. Within grants, Medicaid will increasingly overshadow the other programs.

SCHOOL ENROLLMENT GROWTH

Structural Deficits: This year there is considerable discussion of "structural deficits" in state budgets. The concept of structural, as distinct from cyclical, deficits is fully articulated in California. There, budget information was presented this year in a way that clearly differentiates two portions of the deficit: (1) that built into spending and revenues in an economically typical year and (2) that related to revenue loss and spending increases associated with recession. In some other states, the distinction isn't necessarily calculated in detail, but is used by elected officials to signal an imbalance of revenues and spending built into the state's finances.

The hallmarks of structural deficits are major spending categories that inherently grow at a faster rate than revenues from existing taxes. This is plausible if a spending category is experiencing extraordinary price increases, as in health, or extraordinary growth in the population being served, as in corrections. In more routine functions, such as parks, current service budget concepts would suggest cost growth in line with an indicator like population growth plus a measure of inflation like the Consumer Price Index. Some state spending limits are calculated on that basis.

Education And Structural Deficits: Education accounts for over half of state general fund budgets. Therefore, the question of structural deficits hinges to a major degree on education cost pressures. Put another way, the ability of states to fund education quality measures with existing taxes depends in part on how fast the student population is increasing. Growth in the 1980s is shown on Table 10.

Table 10: Percentage Change In K-12 Enrollment, 1980-1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Massachusetts	-18%	18	Maine	-4%	34	Louisiana	2%
2	West Virginia	-17	19	North Carolina	-4	35	Mississippi	4
3	Pennsylvania	-13	20	Missouri	-3	36	Kansas	4
4	Iowa	-13	21	Nebraska	-3	37	Colorado	5
5	Michigan	-13	22	Arkansas	-3	38	Idaho	5
6	New Jersey	-12	23	Montana	-3	39	Hawaii	5
7	New York	-10	24	Vermont	-2	40	New Hampshire	6
8	Connecticut	-10	25	Wyoming	-2	41	Georgia	7
9	Ohio	-10	26	Minnesota	-1	42	Washington	7
10	Indiana	-10	27	Oklahoma	-1	43	New Mexico	14
11	Illinois	-9		**United States**	0	44	Texas	14
12	Rhode Island	-8	28	Virginia	0	45	California	19
13	Kentucky	-7	29	Oregon	0	46	Arizona	20
14	Wisconsin	-6	30	Delaware	0	47	Florida	20
15	Alabama	-5	31	South Dakota	0	48	Nevada	26
16	Maryland	-5	32	South Carolina	0	49	Utah	28
17	Tennessee	-4	33	North Dakota	1	50	Alaska	29

During the 1980s, education costs weren't *inherently* a major factor in increasing state and local fiscal problems. In most states, they were a cost-increasing factor only because of state and local decisions that cut class sizes, provided early childhood education, and raised school employee compensation substantially faster than inflation. There was almost no change in the number of public school children nationwide from the fall of 1980 to the fall of 1990. Many states experienced significant decreases in enrollment as shown in Table 10.

During the decade, population grew by about 1% a year and the number of persons employed grew even faster. Less than a fifth of the states had this much growth in school enrollment. Having more rapid growth in taxpayers than in students helped states to finance substantial increases in real spending per pupil and in the percentage of school costs paid by states.

Enrollment Projections: Enrollment projections by the U.S. Department of Education suggest that the level enrollment of the 1980s won't persist into the 1990s. Table 11 shows the percentage of projected enrollment change over the 1990s and the number of pupils involved.

Table 11: Projected Change In K-12 Enrollment (000), 1990-2000

Rank	State	Percent	Pupils	Rank	State	Percent	Pupils
1	Arizona	29%	178	26	Alabama	6%	40
2	New Mexico	28	86	27	Mississippi	4	19
3	New Hampshire	25	45	28	Illinois	4	68
4	Alaska	24	27	29	Oklahoma	3	19
5	Florida	21	374	30	New York	3	84
6	Georgia	20	230	31	South Dakota	3	4
7	New Jersey	19	212	32	Washington	3	24
8	Maryland	17	122	33	Oregon	3	13
9	California	16	801	34	Michigan	2	30
10	Virginia	16	162	35	Kansas	2	8
11	Colorado	14	79	36	Arkansas	2	7
12	Delaware	13	13	37	Tennessee	1	11
13	Nevada	13	24	38	Wisconsin	1	4
14	Utah	12	55	39	Wyoming	0	0
15	North Carolina	12	128	40	Louisiana	-1	-7
16	Vermont	12	11	41	Pennsylvania	-1	-15
17	Massachusetts	11	91	42	Nebraska	-1	-3
18	Texas	11	360	43	Indiana	-1	-11
19	Hawaii	10	18	44	Ohio	-1	-22
20	Rhode Island	10	14	45	Idaho	-3	-6
21	Connecticut	9	44	46	Kentucky	-4	-24
	United States	**8**	**3396**	47	Montana	-5	-7
22	Maine	8	17	48	North Dakota	-7	-8
23	South Carolina	7	44	49	Iowa	-8	-37
24	Missouri	7	55	50	West Virginia	-10	-33
25	Minnesota	6	48				

Table 11 shows a nationwide increase in pupils of 8%, slightly below the rate of population growth. The growth is unevenly distributed. Eleven states are projected to have declining enrollment. Four have no change predicted. Half have 5% or smaller increases. Nearly half the projected growth of 3,396,000 pupils is concentrated in California (801,000), Florida (374,000), and Texas (360,000).

These three states are viewed by most local observers as having structural deficits over the long term. Elementary and secondary education is a major portion of the spending pressure in each. The California Proposition 98 guarantees to elementary and secondary education and the implied state aid commitment in Texas school equalization add to the spending commitment.

Higher Education: Projecting higher education enrollment is much more difficult than making elementary and secondary projections. The projections are much more sensitive to decisions affecting: (1) the percentage of high school graduates who attend college, (2) how long they stay in school, and (3) the extent to which those individuals beyond what used to be college age attend school. There is every reason to believe that these decisions are sensitive to tuition policies. If the tuition increasing tendencies of 1990 and 1991 persist, enrollment trends are likely to be significantly affected by price changes.

A key part of the underlying demographics of enrollment at public higher educational institutions is the number of students who graduate from high school in each state. Those trends for some representative states are shown in Table 12.

Table 12: Number of High School Graduates (000), Selected States

State	1991	2000	Percent Change
California	230.6	333.6	44.7%
Florida	86.9	125.0	43.8
Washington	45.4	62.1	36.8
Georgia	57.0	68.6	20.4
United States	**2,232.5**	**2,624.8**	**17.6**
Texas	170.2	198.1	16.4
Pennsylvania	104.0	116.8	12.3
New York	136.6	150.0	9.8
Massachusetts	48.1	52.7	9.6
Michigan	90.4	95.9	6.1
Illinois	103.4	108.6	5.0

The table suggests relatively mild growth in college enrollment from demographic factors. But during the 1980s, much of the increase in enrollment was driven by more persons going to college and staying there longer. The same pattern could be repeated in the 1990s. While the predicted growth in high school graduates is mild nationwide, some states will experience increased demand for places in state universities.

California is one of those states. There have been plans for new campuses, with the higher education coordinating board currently suggesting at least one major university and over 20 community college campuses. These plans are on hold. State fiscal officials have been discouraging new bond issues because of the impact on operating costs and the state credit rating. Responding to these arguments and a general sentiment to vote no on all ballot issues, voters rejected a $450 million higher education bond issue last November. Anticipating an austere FY 1992 budget even if taxes are increased, some campuses are reducing course offerings and limiting the number of students admitted.

REVENUE SHORTFALLS

Revenue Below Expectations: Many states are reporting serious shortfalls in March and April tax revenues. There are some well known reasons for this, but they tend to be forgotten because state memories of revenue performance in recessions date back to the early 1980s. It is reasonable to expect state revenue to respond -- more or less, depending on the state's economy and tax structure -- to changes in personal income. That is, personal income growth of 8% should be, and generally has been, associated with state revenue growth of about 8%. If personal income growth slows to 4%, revenue growth would be expected to slow to about 4% and revenues would be below an estimate based on prosperity-linked 8% growth. This was the expected part, with many state revenue estimates already scaled down to slower growth.

Revenues In Recession: The difficulty is that some aspects of the economy behave asymmetrically in recession, with deleterious effects on tax revenues. First, graduated personal income taxes mean that lower incomes put some taxpayers in lower tax brackets and mean they pay a lower percentage of their income in tax. Second, spells of unemployment in 1990 mean that many households were subject to overwithholding of state income taxes and are getting their money back by refund claims in the spring of 1991. Third, recession disproportionately reduces income subject to withholding, wages and salaries. Less affected are other components of income: (1) income like dividends and interest not subject to withholding and (2) income that is exempt or lightly taxed -- Social Security, welfare payments, and unemployment compensation. These are growing components of the personal income total in a recession.

Fourth, sales tax revenues suffer when consumers have declining borrowing power because they have lost their jobs or declining willingness to borrow because of uncertainty. This affects the purchasing of big ticket items subject to sales tax like autos, boats, furniture, and appliances. Consumers with declining income also don't cut back their spending proportionally. Mortgage payments, health care, credit card and car payments, and food -- all generally not subject to sales tax -- tend to continue. Finally, corporate profits taxes drop in recession because corporate profits drop in recession.

Examples Of Shortfalls: Massachusetts, with severe recession, reflects these factors. Net of tax increases, March collections were down 19.9% from last March. Even with the increases, they were down 4.4%. Collections of sales taxes for the fiscal year through March were down 4%. Regular sales taxes were off 1%, but vehicle sales taxes were down 22%. Corporate taxes were off 27%. Public utility taxes dropped 12%. Georgia's March results were 10.6% below last year's. Administrative savings measures are underway, though state officials still hope for the 3.2% revenue growth assumed in the budget.

BARRIERS TO COST CUTTING

Introduction: In December and January, many governors announced major cost-cutting measures to restore balance to current year budgets and bring FY 1992 spending and revenue in line without tax increases. The effects haven't always been as announced and new cost pressures have developed. This article provides a sampling of the cost pressures and problems, including the interplay of state and local finances.

Firing Teachers: This spring, there have been many reports of teachers, including those who have won prizes of various kinds, being fired. What's happening? In a few cases, the teachers won't be back this fall because (1) they were fired for non-financial reasons, like conduct, but this is rare or (2) their district can't afford them. In the bulk of the cases {**Reports** can't offer quantitative proof}, they are affected by the interaction of local contracts and state fiscal cycles.

Local contracts often give teachers contractual rights for the fall term unless they are notified otherwise in the spring. In the spring, school administrators have uncertainties about the number of teachers who won't be coming back (death, disability, retirement, changing jobs) and about state aid for the new fiscal year. It is not uncommon for them to assume the lowest conceivable attrition and state aid and issue notices accordingly. Teachers, who seem to understand the process much better than the media, then receive notice before the fall that they have been invited to return. Actual layoff of experienced teachers is rare.

The notice requirements sometimes become a tool for school boards, which fail to give notice on a timely basis. This situation developed in Boston in early May. The Boston School Committee rejected the recommendation of its superintendent and the urging of Boston's mayor and refused to notify 349 teachers. The Committee, which gets its financing from the city, wasn't buying the mayor's budget recommendation. The school move blocks layoffs as an option, forcing concentration on other types of cost-cutting measures.

In Indianapolis, the situation is nearly reversed with the school district making its decisions, including pay, premised on a state aid increase of 5%. As it becomes increasingly clear that the Indiana legislature won't provide the increase, the district has announced layoffs of about 600 employees.

Medicaid Costs: The state budget officers (NASBO News, May) have developed summary statistics and projections reflecting the pressures Medicaid costs are putting on state budgets, as shown in Table 13.

Table 13: Medicaid Costs Pressure State Budgets

	State Costs		Total State/Federal
Fiscal Year	Pct. Of Budget	$ billion	Cost ($ billion)
1980	9%	$11	$26
1985	10	18	41
1990	14	31	71
1995 est.	22	67	155

The compilation includes only cost factors associated with existing law, but no new Congressional mandates. However, many new and expensive Medicaid mandates are pending in the Congress.

Medicaid Drug Coverage: New York, and probably other states, is under pressure to adopt additional drugs and treatments in its Medicaid programs at the same time that they attempt to limit the cost of the program. The situation is widespread, affecting procedures (e.g., transplants) as well as drugs. Clozapine is a new drug to treat schizophrenia which costs about $4,000 per year per patient for the drug and $2,500-5,000 for the monitoring and testing associated with its use. In January, a public interest law group sued New York and won a preliminary decision that the state cannot use financial reasons to avoid providing "medically necessary services" under Medicaid. The manufacturer indicates some 40 states already provide coverage, which New York does for persons in its mental hospitals. At $7,000 a case for 10,000 cases, the tab would be $70 million with the federal government paying half and state and local government paying the other half.

Welfare Rules: The governor of Pennsylvania adopted a number of cost-cutting devices affecting welfare recipients which, under Pennsylvania law, are subject to procedures for the review of administrative regulations. By invocation of emergency procedures, three of the rules have gone into effect despite a 3-2 rejection by the Independent Regulatory Review Commission. The three involve raising the copayment on Medicaid prescriptions by 50 cents to $1, cutting off benefits from those convicted of welfare fraud, and limiting transportation expenses for those in job training programs. To continue those policies beyond four months, the administration needs approval from the welfare committees in both Houses of the legislature. A fourth rule, limiting the amount any single household can get from general assistance, was withdrawn in the face of expected opposition in the Commission.

Interactions Of Social Programs: Many cost-cutting proposals are confronted with the argument that cutting funds in one program will increase spending in another one. Some of these arguments are quite general, such as the contention that spending less on schools will cause prison populations to rise.

Others, such as those being made in Massachusetts, are much more specific. Opponents of cuts in general assistance contend they would result in increasing the number of homeless, placing more burdens on the state's extensive programs for them. But one major program for the homeless, state subsidies that are parallel to federal Section 8 rent subsidies (but don't have parallels in most states), are themselves getting the axe. The head of the Massachusetts Housing Finance Agency warns the state can't untangle easily. Many of the 18,000 families getting state supplements of nearly $1,000 a month are living in buildings financed by the Agency. It fears mortgage defaults without the subsidies.

In Maine, the argument against cutting areawide agencies for the aged programs (e.g., homemakers, meals on wheels) is that the result would be greater use of nursing home care. Critics of proposals to limit AFDC eligibility and reduce payment levels argue doing so would increase Maine's state and local general assistance costs.

New York City Problems: Mayor Dinkins drew an audience of an estimated 1.6 million people as major TV and radio stations gave him prime time on May 8 to talk about city finances. He announced "the time for games is over" and that the time to balance the budget had arrived. The mayor is trying to deal with a shortfall of $3.5 billion in an annual budget of $29 billion.

His solution includes about $1 billion in new taxes. These include real property tax increases that require approval of a reluctant council and other increases that require the approval of the state legislature. Major Dinkins has a long list of spending cuts including not operating some street lights, closing the Central Park zoo, cutting back drug rehabilitation programs, eliminating as many as 20,000 jobs, and seeking "givebacks" from public employee unions.

Litigation Over Personnel Actions: The austerity plan in Pennsylvania includes a 10% cutback in the pay of supervisory employees. The 3,000 workers went to court and obtained a temporary restraining order from a state court prohibiting the cut. The state is appealing. The same court had previously rejected the plan as applied to the independent Fish and Game operations. However, about 9,600 management-level employees have been subjected to the cut.

Legislative-Executive Disagreements: Legislative approval of cost cutting proposals by the governors isn't automatic. For example, the legislature in Michigan rejected the governor's proposal to prevent a scheduled 4% employee pay raise from going into effect. Similar disagreements are a major factor in cutback policy in Maine, Massachusetts, and Pennsylvania -- to mention only a few states affected.

TAX INCREASES

How Big Is The Tab? The combination of new revenue shortfalls and frustrations in achieving expected spending cuts auger for tax increases greater than the $6-7 billion requested in governors' budgets earlier this year. The perceived acceptability of increases has probably grown as a result of well-publicized barriers to implementing spending cuts and widespread publicity about deleterious effects of proposed cuts.

Post-Election Tax Hikes: Historically, 1991 may be a good year for tax increases in most states. It is widely believed that governors and legislators seeking reelection are prone to emphasize use of one-time revenues, to defer spending, to overestimate revenues, to underestimate spending, and to draw down balances during election years to avoid tax increases or sharp spending cuts. When elected, the theory goes, state elected officials often enact tax increases. It is true that a large number of governors and legislators elected in 1982 and in 1990 discovered serious fiscal problems in early 1983 and 1991 that they didn't see before the elections. The phenomenon wasn't as significant in 1986 and 1987, when the booming economy was swelling state revenues.

Elections And Tax Timing, Louisiana: The Public Affairs Research Council of Louisiana has quantified the results for that state's budget. The results appear in Table 14, for the first year of each governor's term and the final year (e.g., FY 1992 for the Roemer term than ends in early 1992 after elections in November of 1991). The data support the conclusion that Louisiana officials tended to run deficits in election years, but surpluses (e.g., by tax increases) after elections.

Table 14: Louisiana General Fund Surplus (Or Deficit)
Selected Years, FY 1973 To FY 1992 (est.), Millions Of Dollars

Governor	Election Held	First Year Result	Election Year
Edwards	1971	$23	-$68
Edwards	1975	37	166
Treen	1979	7	-146
Edwards	1983	65	-66
Roemer	1987	1,167	-386

Elections And Tax Timing, US: The same calculation can be made for states in the aggregate as shown in Table 15. Most states held statewide elections in 1990 and four year intervals before that, but the table lumps those states with others on different schedules.

Table 15: Percentage Increases In State Taxes

Year Of Election	Percent Increase In State Taxes	
	Year Of Election	Year After Election
1966	1.7%	7.8%
1970	1.7	9.7
1974	0.5	2.0
1978	-2.0	-1.6
1982	1.8	4.8
1986	0.5	1.9
1990	3.0	?.??
Average	1.0%	4.1%

The average increase in pre-election years was 1%. A substantial part of it was in the minority of states that don't hold statewide elections in the years shown. For example, New Jersey, which held statewide elections in 1989, didn't raise taxes in that year but contributed a major portion of the 1990 state tax increases. The math is only suggestive, but if the 1991 tax increases are 3% above those of 1990, reflecting the pattern shown on the table, then state taxes will be increased by over $17 billion in 1990. This would surpass (without inflation adjustment) the previous highs of increases between $8 billion and $9 billion last year and in 1983.

California's Tax Choice: California is the first major example of a governor who revised original budget recommendations to allow for higher taxes. Recognizing that the California budget gap has grown from under $7 billion to nearly $13 billion, Governor Wilson has recommended a new package of tax increases and spending cuts. His primary tax choice was the sales tax with (1) extensions of the tax base to snack foods, candy, aviation fuel, newspapers, and more and (2) an increase in the rate by 1.25%, which will bring the rate to about 8% in many California communities. A package previously submitted by legislative leaders relied heavily on increasing the top bracket rate of the income tax. In defending his choice, Wilson called the sales tax "the least threatening to the creation of the new jobs that our state must have to avoid greater unemployment and greater safety-net costs that would take California into an onward and ongoing downward spiral."

There are other examples. New York's budget compromise appears likely to include somewhat different and higher tax increases than those proposed by the governor. The governor of Texas has conceded that rejection of her lottery proposal and enactment of the school finance plan will, contrary to her original recommendation, require new taxes. A subtle tax increase, developed by ending a deduction in the income tax, appears to have a good chance of being included in the Illinois fiscal plan.

MISCELLANY

Export Reliance: As recession worries continue, one possible source of recovery for some state economies is exports. There is considerable interest in state economic development agencies in measuring exports on a state-by-state basis, but there are many data problems. A new Census Bureau report provides relatively antique data, but illustrates the importance of manufacturing exports. The data are shown in Table 16 (next page).

Gambling: Connecticut is facing a difficult problem of deciding how much gambling is too much. Legal gambling in the state includes jai alai, dog racing, the lottery, and off-track betting. No casino gambling has been authorized, but charitable organizations are allowed Las Vegas nights. This authorization, combined with the federal Indian Gambling Regulatory Act, allows the Pequot Tribe (under 300 people) to establish a $50 million casino -- at least as the Tribe sees the situation. Connecticut officials didn't agree, but have lost in lower court. In April, the U.S. Supreme Court refused to consider the case.

The tribe is building while the governor looks for a way to avoid casino gambling. The only way may be to eliminate Las Vegas nights, but the charities benefiting from them object. On the theory "if you can't beat them, join them," there is some sentiment for the state to legalize casino gambling off reservations.

Table 16: Percent of Private Sector Jobs Linked With Manufacturing Exports, 1987

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	9.2%		**United States**	**6.3%**	33	Kentucky	5.4%
2	Washington	9.1	18	Idaho	6.2	35	Colorado	5.0
3	Vermont	8.9	18	New York	6.2	35	Georgia	5.0
4	New Hampshire	8.2	18	Pennsylvania	6.2	37	Florida	4.8
5	Massachusetts	7.9	21	Alabama	6.0	37	Utah	4.8
5	Michigan	7.9	21	New Jersey	6.0	39	Virginia	4.7
7	Ohio	7.8	23	Alaska	5.9	40	Oklahoma	4.6
8	Rhode Island	7.5	24	Tennessee	5.8	41	Nebraska	4.5
8	South Carolina	7.5	24	West Virginia	5.8	42	South Dakota	4.4
10	Indiana	7.4	26	Arkansas	5.7	43	Louisiana	4.3
11	Wisconsin	7.3	26	Iowa	5.7	44	Maryland	4.0
12	California	7.2	26	Maine	5.7	45	North Dakota	3.7
13	Minnesota	7.1	26	Missouri	5.7	46	Montana	3.2
13	Oregon	7.1	36	Texas	5.7	47	New Mexico	2.9
15	North Carolina	6.5	31	Kansas	5.6	47	Wyoming	2.9
16	Arizona	6.4	32	Mississippi	5.5	49	Nevada	2.4
17	Illinois	6.3	33	Delaware	5.4	50	Hawaii	1.9

Kids Count: A new report (see Technical Notes) uses some standard indicators, like infant mortality rates, to define how well children are doing in each of the states. Nationally, the report suggests improvements in some indicators (e.g., young child death rates), but little progress in others (e.g., low birth weights). The rankings of the states tend to correlate with per capita income. The top ranked states for 1991 were: (1) Vermont, (2) Utah, (3) Minnesota, (4) New Hampshire, (5) Connecticut, and (6) Rhode Island. Poorest conditions were found in (46) New Mexico, (47) Mississippi, (48) South Carolina, (49) Louisiana, and (50) Georgia.

Medicaid Service Rationing: Oregon's plan to rationalize decisions on what services to cover under Medicaid received extensive publicity well in advance of implementation. The detailed plan still hasn't received either legislative approval or the federal waiver required to begin operation.

The issues that the plan explicitly raises are those faced in all states where they typically aren't raised. For example, if there is money to do only one, is it better to do one expensive transplant for a 70-year old or to provide preventive services for 400 youth? Rather than express an opinion, it is easier to be for providing enough money to do both. For an excellent discussion of the priorities issue, using Oregon as an example, see the article by David Hadorn (RAND Corp.) in the Journal of the American Medical Association (5/1) and comments by Normam Daniels (Tufts U.).

University Costs: The usefulness (and arguably mischief) of interstate comparisons of aspects of state spending is suggested by university comparisons developed by New York's Comptroller (State Office Building, Albany, NY 12236). The 40-page report on the state's university system (Staff Study Comparing SUNY Finances With Similar State Universities) uses data on peer institutions in other states to establish that certain costs are *prima facia* too high in New York. The university system has complaints about the numbers and some numbers of its own, which adds another 33 pages. **Reports** is not in a position to affirm or criticize the numbers, but offers some key ones in Table 17. {For detailed definitions, see Technical Notes.}

Table 17: Costs (000) Per Full-Time Student, Selected States, FY 1989

State	Large Univ.	Four Year A	Four Year B	Two Year
Ohio	$7.7	$6.7	$5.3	$4.2
Indiana	9.9	4.9	5.3	6.1
Illinois	10.5	7.1	n.a	3.5
Michigan	10.7	6.3	5.7	5.3
Iowa	11.1	6.7	n.a	6.1
New York	11.7	6.6	8.0	6.4
Washington	12.1	6.4	8.2	3.6
Texas	12.5	4.1	7.2	6.3
Florida	13.6	8.5	n.a.	n.a.
North Carolina	17.2	n.a.	n.a	4.7
Median For Category	11.1	6.4	6.4	4.6

The report also presents a comparison of university teaching hospitals which show that most just about break even, with revenues within 6% of spending. The exception on the high side was Wisconsin's which earned 6.5% on sales. On the low side was New York, where three medical schools combined lost $80 million, or 20% of revenues, in FY 1989. The big loser was the University of Texas which lost $115 million, more than its revenues. The big difference probably reflects: (1) how generous each state's Medicaid program is and (2) how aggressively the teaching hospital seeks to qualify patients for Medicaid. The Texas comptroller has been issuing reports claiming the state loses hundreds of millions each year by not taking advantage of Medicaid.

Items: Pat Uunnicke assesses the think tanks that deal with state policy issues in State Legislatures (March). Will hard pressed states and cities sell so many assets to the private sector that securities firms can develop a new line of business around their decisions? This question is asked in an article in the Wall Street Journal (5/9) which reports that some firms are establishing new units to handle the business.

TECHNICAL NOTES

Federal Funds: The statistics are from the Commerce Department's Federal Expenditures By State For Fiscal Year 1990. There are counterpart reports for political subdivisions of states in the two volumes of Consolidated Federal Funds Report, Fiscal Year 1990. The per capita statistics (excluding a small quantity of "other") are grouped below by state for reader convenience in assessing where a particular state stands in total and why. The calculations distributing federal tax burdens by state are developed by the Tax Foundation (470 L'Enfant Plaza, SW, Washington, DC 20024). The Foundation popularizes them in "tax freedom day" calculations, most recently appearing in its Special Report (April).

Education Costs: The projections are from the U.S. Department of Education, Projections Of Education Statistics To 2001: An Update.

Post-Election Tax Increases: Table 15 relies on data from NCSL's annual State Budget And Tax Actions and, for earlier years, information compiled by Steven Gold (State University of New York at Albany).

Manufacturing Exports: The Census Bureau report is Exports From Manufacturing Establishments.

Kids Count: The Kids Count Data Book is the product of The Center For The Study Of Social Policy, 1250 Eye St., NW, Washington, DC 20005. The indicators presented for each state are two indicators of infant health (low birth weight, infant mortality), two of children's deaths (total and teen violent deaths), out-of-wedlock births to teenagers, high school graduation rate, poverty rate, and juvenile incarceration rate. The National Conference of State Legislatures 91560 Broadway, Denver, CO 80202) has enough special publications on state policies toward children to merit a special little catalogue of them.

University Costs: The comptroller defines categories in detail in the report. In summary, large universities have a medical school but not hospital, the first category of four year institutions offers masters degrees and a few doctorates, the second category doesn't offer doctorates.

Table A-1: Per Capita Federal Impacts, FY 1990 With Ranks

State	Total		Grants		Salaries		Payments		Procurement	
	Rank	Amount	Rank	Amount	Rank	Amount	Rank	Amount	Rank	Amount
Virginia	1	$5,874	49	$361	3	$1,665	20	$2,024	2	$1,643
Alaska	2	5,867	1	1,303	1	2,249	50	1,113	10	962
New Mexico	3	5,703	10	633	5	897	33	1,882	1	2,149
Maryland	4	5,671	33	491	4	1,276	17	2,053	4	1,400
Massachusetts	5	4,949	9	641	35	440	6	2,203	3	1,464
Hawaii	6	4,927	22	540	2	1,954	34	1,835	27	494
Missouri	7	4,741	44	425	23	558	9	2,109	5	1,360
North Dakota	8	4,555	6	737	8	800	23	1,999	39	256
Connecticut	9	4,484	15	600	41	385	28	1,967	6	1,352
Colorado	10	4,428	43	434	6	837	44	1,726	7	1,227
Rhode Island	11	4,303	4	770	24	556	4	2,283	21	598
Alabama	12	4,272	25	520	15	682	7	2,126	13	839
Montana	13	4,186	5	740	16	654	15	2,057	44	209
Washington	14	4,140	24	528	9	736	30	1,917	14	810
South Dakota	15	4,114	7	734	11	722	25	1,990	49	171
Arizona	16	4,112	41	442	22	558	21	2,014	8	1,001
Wyoming	17	4,089	2	1,253	12	694	47	1,698	35	322
Maine	18	4,011	12	621	32	457	12	2,090	15	767
Florida	19	3,970	50	354	29	510	1	2,541	26	511
South Carolina	20	3,919	20	542	13	690	40	1,777	16	764
New York	21	3,918	3	876	44	357	13	2,090	28	479
Mississippi	22	3,912	13	620	31	500	19	2,041	20	628
California	23	3,891	37	468	19	596	43	1,729	9	991
Idaho	24	3,862	16	565	30	505	39	1,790	12	856
Nebraska	25	3,860	32	494	18	603	24	1,993	37	270
Kansas	26	3,850	45	412	20	591	18	2,043	30	457
Pennsylvania	27	3,823	27	515	37	433	3	2,425	33	350
Utah	28	3,779	34	487	7	828	49	1,446	11	896
Oklahoma	29	3,753	30	498	10	725	14	2,076	36	278
Tennessee	30	3,701	18	557	33	456	29	1,942	18	678
West Virginia	31	3,685	17	562	45	335	2	2,494	48	181
Kentucky	32	3,670	19	555	28	521	27	1,972	25	545
New Jersey	33	3,664	28	514	36	439	10	2,105	23	557
Iowa	34	3,587	38	464	48	264	16	2,054	40	252
Louisiana	35	3,582	11	630	34	442	36	1,817	22	565
Arkansas	36	3,509	23	532	40	396	5	2,249	50	166
Ohio	37	3,496	31	497	43	362	22	2,008	24	557
Oregon	38	3,457	14	601	38	417	11	2,097	42	228
Nevada	39	3,448	48	368	26	537	37	1,811	17	690
Minnesota	40	3,445	21	541	47	308	45	1,724	29	475
Texas	41	3,428	46	406	27	533	46	1,699	19	660
Georgia	42	3,265	35	484	14	683	48	1,673	34	344
Delaware	43	3,226	36	470	21	576	32	1,905	45	208
Illinois	44	3,210	39	462	39	416	26	1,985	43	228
New Hampshire	45	3,209	47	385	17	624	42	1,735	31	388
Vermont	46	3,148	8	670	42	373	35	1,821	46	190
Michigan	47	3,142	29	511	49	262	8	2,116	47	183
Wisconsin	48	3,052	26	519	50	245	31	1,916	38	258
Indiana	49	3,051	42	437	46	325	38	1,808	32	356
North Carolina	50	3,043	40	444	25	538	41	1,741	41	240
United States		**3,974**		**533**		**579**		**1,973**		**747**

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Legislators are debating the merits and mechanics of concentrating state tax increases on the rich. A new report suggests most states concentrate burdens on the poor. State decisions on tax increases this year reflect no consensus on what is best.

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June 1991 (First of Two June Issues)

STATE BUDGET DEVELOPMENTS

The Search For Solutions: Officials of the largest states are continuing their struggle to find acceptable ways to enact balanced budgets. Of the ten largest states, with 55% of the nation's population, nine hadn't reached agreements on the broad outline of budget policy by the end of May. That is, there wasn't agreement on how much of the budget problem would be handled by spending cuts and how much by tax increases. Nor was there agreement on what spending cuts or what tax increases would be used. The exception was Florida, where the agreements include one to address "tax reform" (the euphemism for tax changes, including a possible income tax or major broadening of the sales tax) next year.

Public Opinion on Shortfalls: A Michigan public opinion poll suggests the difficulties elected officials face in dealing with state fiscal problems. Only 9% of those interviewed would increase taxes enough to avoid any reduction in state services, leaving 91% looking for some action to cut spending.

Most of those responding would accept a combination of spending cuts and tax increases. But there is substantial opposition to tax increases despite the widespread publicity about Michigan budget problems. About 30% of Michigan voters would reduce state services to avoid raising taxes. This isn't surprising as more than a third of Michigan voters believe that over 25% of state revenues are wasted. Fifty-six percent think state taxes are too high.

The survey indicated strong support for: eliminating welfare for able-bodied men and women (81%), rejecting a 4% pay raise for state employees (71%), reducing the number of state employees (67%), and allowing private businesses to provide state services (61%). The strongest opposition among the choices offered was to closing mental hospitals (75% opposed), reducing grants to foster parents taking care of needy children (69%), reducing free health care insurance for the poor (68%), and reducing welfare payments for poor women with children (62%).

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Revenues Lagging: State revenues in FY 1991 through March have lagged behind collection growth in prior years. They were well below expectations of officials in most states. According to a new survey, state tax revenue growth has only been 3.1%. The growth for the 20 largest states is shown in Table 1.

Table 1: Percent Increase Of State Tax Revenue
Fiscal Year To Date, 1991 Versus 1990, 20 Largest States

State	Percent	State	Percent	State	Percent
New Jersey	14.0%	**United States**	**3.9%**	California	1.8%
Washington	6.7	Minnesota	3.8	Tennessee	0.9
Missouri	6.4	North Carolina	2.7	Michigan	0.8
Illinois	5.9	New York	2.4	Ohio	0.8
Florida	4.5	Massachusetts	2.2	Pennsylvania	0.3
Wisconsin	4.5	Indiana	2.1	Maryland	0.1
Texas	4.3	Georgia	1.9	Virginia	-1.4

Spending Cutbacks: Both the National Conference of State Legislatures and the National Governors' Association have recently released tabulations of measures being taken to cut back state spending. In its Fiscal Survey, NGA and the state budget officers list budget-balancing measures proposed by governors, including revenue increases as well as ways to cut spending. The primary measures are listed in Table 2.

Table 2: Budget-Cutting Measures Proposed Or Implemented, 1991

Cost-Cutting Measure	Number Of States
Spending Reductions Affecting Many Agencies	
Across-The-Board	16
Targeted	24
Spending Delays Other Than Pension Funding	13
Pension Funding Delays	10
Measures Dealing With State Employees	
Hiring Freeze	22
Layoffs	11
Furloughs	7
Travel Freeze	19

The NCSL survey, State Cutback Management, includes a review of a survey from the early 1980s indicating that governors have "virtually unlimited authority to reduce the budget to avert a deficit" in about 20 states. The governor needs legislative authorization for just about any cut in about ten states. In the remainder, the governor has authority to make cuts, but there are restrictions on the power.

Biting The Hand That Feeds You? Many governors apparently didn't buy the argument that revenue-raising agencies should be exempt from cuts. A survey by the Federation of Tax Administrators identified 25 state tax agencies that had their operating budgets reduced. Cuts ranged from 1.5% to 13%.

Legislative-Executive Disputes Over Cuts: The governor's authority to make cuts without legislative action gives rise to disputes in every state. The controversies in Massachusetts, Michigan, and Pennsylvania involve particularly difficult and significant issues. In Pennsylvania, one issue is the governor's authority to close state institutions, particularly one for veterans' children. The legislature passed a bill restricting the authority. The governor vetoed it.

In Massachusetts, the legislature has sought to block institution closings and modified the governor's pay reduction plan so it covered cabinet officers. In Michigan, the Speaker and others have filed suit to block 11 fund transfers. They involve eliminating general assistance for nearly 100,000 recipients, supplementing Medicaid funding, and restoring funding for foster care, among other things.

Court Decisions Increasing State Costs: There is a continuing parade of federal and state court decisions with the impact of increasing state government costs. Legal issues in Missouri, Ohio, and the District of Columbia are a sampling.

In a federal appeals court decision in May, Missouri continued its failure to avoid escalating costs for broadly defined desegregation costs in Kansas City schools. The state has been resisting the costs on the grounds, among other things, that they drain funds from education in the rest of the state to fund education programs that are more expensive in Kansas City than elsewhere. By school finance criteria, other Missouri districts are more deserving of state aid. The state's case is summarized by the comment of an assistant attorney general: "This case isn't about black and white, it's about green." The new decision ups the state's costs for operating expenses, asbestos removal, and school construction costs.

The concept of the Kansas City case hasn't been lost on other districts, particularly St. Louis and Little Rock where the situations were somewhat similar. Other districts are looking for some of the same action. The Lorain (OH) district entered into a consent decree six years ago with desegregation plaintiffs. That decree also involved the State of Ohio which agreed to put up $1 million, which it has done. But the current costs of the program, as developed by the district, have escalated to $7 million a year. Lorain wants the state to split the higher costs with the district. So the district is now in federal district court trying to get an order requiring the state to pay.

There are about 360,000 children nationwide in foster care systems. These systems are subject to many criticisms, which are likely true to varying degrees in individual states. According to critics, the agencies dealing with foster children don't investigate child abuse on a timely basis, don't help the natural family enough so that foster care can be avoided, don't provide adequate foster care settings, have excessive caseloads for the caseworkers, don't keep adequate records, leave children in temporary settings too long, and more.

In the words of a federal district court judge, the result can be "a lost generation of children whose tragic plight is being repeated every day." The court concluded that the federal Adoption Assistance Act conferred rights on the affected children as well as establishing the federal aid program. Further, it concluded that even if a state didn't accept adoption assistance money, it was subject to judicial control because its administration of child welfare violated constitutional rights. If followed by other federal courts, this decision affecting the District of Columbia could do for federal court handling of child welfare in all states what has already happened with federal jurisdiction over state prison administration.

Medicaid reimbursement litigation is underway in many states. In Massachusetts, the nursing homes are in court seeking preliminary injunctions to preclude reimbursement cuts from being made. In many states, hospitals and nursing homes are looking for adjustments of past reimbursements as well as protection against cuts.

Impacts On Local Government: Fiscal pressures are causing major adjustments in the fiscal relations of state and local governments. The responses this year are pragmatic, but are falling into patterns. They include:

(1) Less unrestricted state aid to cities and counties. Examples are the cuts in Massachusetts and proposed cuts in Illinois and New York.

(2) Less use of the state tax system to offset part of the burden of local taxes. Examples are the reduction or elimination of the renters' credit in California, the elimination of state funded property tax relief in Maine, and the proposed elimination of the property tax deduction in Illinois.

(3) Serious efforts to reduce the mandates imposed by states on local governments. Examples are California, Massachusetts, and New York.

(4) Increasing local flexibility to use local option taxes. Old examples are local option sales taxes in South Carolina and Wisconsin. Pending examples are the shift of taxing authority and spending responsibility to California counties, proposed local sales taxes in North Carolina, new revenue options in

New York, and the proposed relaxation of Proposition 2 1/2 in Massachusetts. Existing local option sales taxes also automatically gain revenue from the many proposals to broaden the state sales tax base.

(5) A more unusual move, though conceptually similar to the others, was New Mexico's decision to end the exemption for local government sales. As a result, the state sales tax will now apply to local garbage and sewer charges, to sales by university bookstores, and to tickets to university sporting events.

Delaying Local Aid Payments: Local governments are providing flexibility for some states seeking to deal with cash flow problems or "balance" their budgets by delaying payments. This works in cash systems but not in states using generally accepted accounting principles. Michigan, confronted by an unexpected shortfall associated with court decisions on the single business tax, appears likely to delay payments to local governments, school districts, and perhaps universities. Delay also appears likely in Massachusetts, where delays would be combined with reductions in state aid for FY 1992. In New Hampshire, the latest budget balancing plan includes deferring payments of state revenue sharing funds for an entire year and phasing out the state's contribution to retirement plans of police officers, fire fighters, and teachers. New York local payments are late this spring because they depend upon a $4 billion borrowing, which depends upon enactment of the budget, which is late. New Jersey is delaying its annual payments to municipalities for replacement of revenues from the personal property tax.

Uncertain state aid payments are one of the factors causing concerns about the ability of some major cities to repay debt. See, for example, "Fear Of Big Defaults Roils Muni Markets," Wall Street Journal (5/17). Uncertainties about state aid are part of the problem in some of the jurisdictions cited -- Chicago, Detroit, New York City, and Philadelphia. But three situations not involving delayed receipt of state aid -- Washington, D.C., Massachusetts, and New York -- were also cited.

State Takeover Of Local Government: Many states have laws involving some sort of receivership for local governments. Most of these are aimed at governments with massive deficiencies in financial management. They are most often used in cases of governments with only a few employees. There are also statutes in some states reflecting the same principles, but with much more elaborate mechanisms for financial control. The model is the New York statute passed in the mid-1970s to deal with New York City financial problems through a "financial control board." That statute may be retriggered by current financial problems of the city. Other examples of use are Cleveland (OH) and Yonkers (NY). One aspect of the loan being made to the Richmond (CA) School District (see below) is state supervision of district finances.

Takeover For Policy Reasons, New Jersey: None of these arrangements are aimed at the quality or quantity of services provided by local government. The New Jersey statute for receivership of school districts is entirely different, with the takeovers based on educational failures, not financial ones. The state has already taken over the Jersey City schools. In April, it set in motion the procedures for taking over the Patterson schools. These are two of the state's largest school districts.

School Bailout In California: "A precedent for irresponsibility" was Governor Wilson's description of a California lower court's decision requiring the state to come to the rescue of the Richmond School District. The district spent at a rate it couldn't sustain for the entire school year. It announced this in April and initiated a quest for bankruptcy protection in the federal courts. The San Jose (CA) District filed in much the same way in 1983, but never went through with the process. The Richmond district had sought a loan from the state. But the state's conditions, such as the right to suspend union contracts, were unacceptable to the district.

The judge's ruling used the same rationale as the school funding cases. She concluded that by letting the district close, the state wouldn't be providing equal educational opportunities to the Richmond students. The ruling is, as far as is known to **Reports**, unprecedented. California is appealing on the basis, among other things, that such a precedent would encourage any school administrator wanting to spend more than the budget to do so and then have the state ordered to pay for completing the school year. In the words of the governor's spokesperson, the decision "sends a signal to all other school districts that they do not have to be fiscally responsible and can overspend to the point of bankruptcy and not have to worry, because the state is required to pay their bills."

The status of the litigation is uncertain. Two independently elected state officials, the Superintendent of Public Instruction and the State Controller, announced they were planning to provide a loan of $19 million to the district. They are using funds appropriated for various education programs, apparently with enough discretion in the legislation to permit the superintendent to use them for this purpose. The attorney general, on behalf of the governor, is also contesting the use of the funds, which were appropriated for a loan to another school district and for driver education. The funds were subsequently determined not to be needed for those purposes. It is unlikely that there will be a final court decision until after the funds have been spent, as the attorney general's effort to obtain an injunction failed.

CORRECTIONS COSTS AND RESULTS

> People say, "Wouldn't you rather spend the $266 million on education?" I'd rather spend it on just about anything else, but that doesn't answer the question.
>
> Comment of Wisconsin's Corrections Secretary while defending his new construction program

Corrections Costs And Inmate Increases: Corrections and Medicaid are producing double-digit increases in state budgets. Given sluggish performance of revenues from current taxes, they can be viewed as two of the major causes for cutbacks in other programs and state tax increases. The natural result is for those interested in funding for other programs and/or in avoiding tax increases to take a hard look at causes of large spending increases in these programs.

In corrections, finding the cause of higher costs isn't hard. The inmate population in 1990 grew 8.6% from 1989, according to statistics just released by the U.S. Department of Justice. Combining an 8% increase in inmates with inflation in cost-per-inmate of 3-6% (depending on such factors as food prices and employee pay increases) produces numbers for corrections operating budget increases of 11-14%. The prisoner growth rate is shown in Table 3.

Table 3: Percentage Increase In Inmates, CY 1989 To CY 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	23.0%	18	New Jersey	8.7%	34	Virginia	5.2%
2	Washington	15.4		**United States**	8.6	35	Utah	4.8
3	New Hampshire	15.1	19	Maryland	8.5	36	New Mexico	4.3
4	Texas	13.7	20	Arizona	8.3	37	Ohio	4.3
5	Alabama	13.2	21	Michigan	8.3	38	Nevada	4.1
6	Idaho	12.1	22	Wisconsin	8.3	39	Maine	3.4
7	California	11.6	23	Rhode Island	7.9	40	Indiana	3.2
8	Illinois	11.3	24	Louisiana	7.8	41	Kansas	2.9
9	Florida	11.1	25	North Dakota	7.7	42	Minnesota	2.4
10	Iowa	10.7	26	South Dakota	7.4	43	West Virginia	1.9
11	Georgia	10.1	27	Missouri	7.2	44	Colorado	1.6
12	South Carolina	9.5	28	New York	7.2	45	Nebraska	0.4
13	Wyoming	9.3	29	Arkansas	6.5	46	Delaware	-2.3
14	Kentucky	8.9	30	North Carolina	6.5	47	Tennessee	-2.3
15	Pennsylvania	8.9	31	Mississippi	6.2	48	Hawaii	-2.5
16	Vermont	8.8	32	Oklahoma	6.2	49	Alaska	-3.0
17	Massachusetts	8.7	33	Montana	6.1	50	Oregon	-4.6

The costs of the increase shown in Table 3 were substantial. Prisons added 58,808 inmates in one year. At $25,000 an inmate per year, this added about $1.5 billion to the annual corrections bill.

About another $3 billion is involved as a one-time outlay for construction of additional facilities. This makes the cost of the policies and conditions resulting in the one-year increase shown in Table 3 about $18 per capita.

Cracking Down On Crime: The policy choices driving this increase are a major issue in many states, with Wisconsin providing an example. The governor, particularly concerned by a record number of homicides in Milwaukee, called a special session in January. He sought action on eight bills, including a mandatory one-year sentence when felonies are committed with dangerous weapons. This would increase sentences in some cases substantially because Wisconsin gives judges considerable discretion in sentencing in such cases. The legislature, so far, has declined to enact the recommendations. The governor also proposed an extensive prison construction program, but the legislature countered with a citizens study panel. To avoid immediate costs, the governor suggested private construction with leasing to the state.

Policies like mandatory sentences, the length of sentences, and the use of probation and parole create massive differences among the states in the incarceration rate, the number of persons in prison per 100,000 population. Nationally, the rate is 293, meaning that about 0.3% of the population is locked up. State rates are shown in Table 4.

Table 4: Incarceration Rates, 1990

Rank	State	Rate	Rank	State	Rate	Rank	State	Rate
1	South Carolina	451	17	Ohio	289	34	New Mexico	184
2	Nevada	444	18	Missouri	287	35	Pennsylvania	183
3	Louisiana	427	19	Arkansas	277	36	Montana	174
4	Oklahoma	383	20	Virginia	274	37	Washington	162
5	Arizona	375	21	New Jersey	271	38	Rhode Island	157
6	Alabama	370	22	North Carolina	264	39	Hawaii	150
7	Michigan	366	23	Kentucky	241	40	Wisconsin	149
8	Alaska	348	24	Connecticut	238	41	Utah	143
9	Maryland	347	25	Wyoming	237	42	Nebraska	140
10	Florida	336	26	Illinois	234	43	Iowa	139
11	Georgia	327	27	Kansas	227	44	Massachusetts	132
12	Delaware	321	28	Indiana	223	45	Maine	118
13	California	311	29	Oregon	221	46	New Hampshire	117
14	Mississippi	311	30	Colorado	209	47	Vermont	117
15	New York	304	31	Tennessee	207	48	West Virginia	85
	United States	**293**	32	Idaho	201	49	Minnesota	72
16	Texas	290	33	South Dakota	187	50	North Dakota	67

State policy differences appear to be the critical variable causing the differences in Table 4. There are large differences among adjoining states. For example, the South Carolina rate is 38% above

Georgia and 71% higher than North Carolina. Minnesota ranks 49th while Michigan is seventh and Wisconsin is 40th.

Legislative Responses To Prison Cost: As indicated by the legislative response in Wisconsin, there is some aversion to further additions to the percentage of the nation's population that is locked up. Part of the concern is programmatic, resulting from suspicion that greater use of community corrections alternatives would be preferable in discouraging recidivism. Part is purely fiscal. Decisions to delay opening correctional facilities in Illinois and Michigan are an example. But legislators are reluctant to reject proposals for stiffer sentences for rape, use of weapons in commission of a crime, drug dealing, drunk driving, and second offenders. This implies a policy of financing the prison construction and operating costs associated with a stiff sentencing policy. The relief valve is the early release programs that shorten terms of those just about ready for release to make room for new prisoners.

A few states have acted to change their sentencing procedures. Delaware, for example, has a "Sentencing Accountability Commission" that has produced substantial revision of sentencing procedures and a reduction in inmates that appears in Table 3.

TAXING RICH AND POOR

Taxing The Rich: The perceived need for tax increases in many states has produced considerable interest in which income groups should bear the added burdens. Proposals to concentrate impacts on high income households are common. This was a characteristic of the income tax portion of last year's increase in New Jersey. Raising the top bracket rate is being strongly urged this year in California, Minnesota, New York, and many other states.

The objections to tax-the-rich proposals are made primarily in the name of economic development. The debate is often partisan, with Democrats supporting and Republicans opposing proposals for higher income tax rates in the top bracket. But the issue doesn't always break on party lines. For example, Governor Cuomo (D) is a major opponent of higher top bracket rates in New York.

Income Taxes: The interest in progressive taxation appears in proposals to adopt income taxes in the states that don't have them. It also appears in states with taxes that have a single (flat) rate. Flat rate income taxes are progressive (taking a higher proportion of income of higher income taxpayers) when comparing lower income taxpayers with middle income taxpayers because the value of exemptions and standard deductions is greatest proportionally for low income taxpayers. But middle income and higher income taxpayers pay about the same percentage of income in tax. As a result, there is always interest in moving from flat rates to graduated rates in the flat rate states, but no recent changes in state policy. The most serious effort this year appears to be in Massachusetts, but both legislative approval and voter acceptance of a constitutional amendment would be required for any change. The same is true in Pennsylvania, where the constitutional amendment has been voted out of committee, but with dim prospects for passage. A progressive (graduated rate) tax is being offered by some Connecticut legislators as an alternative to the governor's proposal for a flat rate.

Picking Which Tax To Raise: The impact of tax proposals on the rich and poor is also an element of debates on whether to raise income or sales taxes. Sales taxes are generally conceded to be regressive -- taking a greater proportion of the incomes of the poor than of the rich. In California, the governor's plan relies primarily on the sales tax. Legislative leaders want to make higher income taxes for the more affluent part of the budget-balancing package. The issue is also hot in Minnesota where the legislative majorities (D) are looking for an increase in top bracket income taxes, which the governor opposes. As part of the symbolism of taxing the rich, some Minnesota legislators have proposed special taxes on luxury items such as cosmetic surgery and caviar.

Assessing Who Pays State Taxes: Recently a public interest group, Citizens for Tax Justice, issued an assessment of each state's state and local tax system in terms of the tax paid by each income group as a percentage of personal income. The effective tax rate for selected states appears as Table 5. It shows state and local taxes as a percentage of incomes of the poorest income group, a middle income group, and the taxpayers with the top 1% of incomes in the state. The rank column is based on a summary measure of regressivity of state and local taxes, with the most regressive arbitrarily ranked highest. {Data for all states and methodological comments appear in Technical Notes at the end of this issue.}

Table 5: Effective State And Local Tax Rates, 1991
Taxes As A Percentage Of Income, Various Income Groups

Rank	State	Low	Middle	Rich	Rank	State	Low	Middle	Rich
2	Texas	17.1%	8.4%	3.1%	34	Massachusetts	13.6%	11.3%	8.9%
3	Florida	13.8	7.6	2.7	36	California	14.1	8.8	10.6
6	Tennessee	15.2	7.7	3.6	39	Ohio	13.4	10.0	9.6
9	Pennsylvania	15.9	9.8	5.5	41	North Carolina	10.6	9.7	8.4
10	Illinois	16.5	10.8	6.0	42	New York	14.1	13.9	11.3
17	Nebraska	16.9	11.5	8.6	44	Maryland	8 .0	10.9	8.1
18	Kansas	13.2	9.7	6.8	46	Minnesota	9.5	10.5	9.6
19	Mississippi	12.9	8.6	6.7	47	Oregon	9.8	10.5	9.9
	United States	13.8	10.0	7.6	50	Vermont	7.4	9.2	9.6

Table 5 provides a sampling of contrasting state situations. The most regressive systems are found in states like Texas and Florida with no personal income tax and thus high reliance on property and sales taxes. They are followed by states with flat rate income taxes, like Illinois and Pennsylvania, or partial income taxes like the Tennessee tax on dividends and interest. High reliance on property and/or sales taxes puts states like Nebraska, Kansas, and Mississippi with higher regressivity than the national average. Low reliance on sales taxes and a highly progressive personal income tax puts states in the less regressive category.

Overall, as measured by CTJ, the state tax systems are regressive. State and local taxes take nearly 14% of the income of the poorest 20% of the population while taking less than 8% of the richest 1%. The simple reason is that consumption doesn't vary proportionally to income. A household with ten times the income of another doesn't smoke ten times as many cigarettes, register ten times as many cars, own a house ten times as expensive, or purchase ten times as much. Because state and local tax systems are heavily oriented to consumption, they tend to be regressive unless a highly graduated personal income tax is part of the mix.

Comparing Burdens Among States: Table 5 and most of the CTJ study focus on comparing the tax treatment of rich, poor, and middle income persons within the same state. For that purpose, how the tax burden is distributed is the key, not how large the tax burden is. Tax burdens are typically compared among states with an aggregate measure, like taxes as a percentage of personal income. But CTJ points out that differences among states in the distribution of tax burdens can cause a state to be a high tax state for some group, like the rich or the poor, even though overall it might not be a high tax state. Table 6 shows the states with the highest and lowest burdens for each of the income classes. The data show the top and bottom ten states in taxing each group and the taxes as a percentage of income for that income grouping in that state.

The Outlook: There is little evidence from state actions this year that there will be a dramatic change in the progressivity/regressivity of state and local taxes. The proposals that would dramatically increase progressivity by enacting an income tax and rolling back sales taxes are in trouble, but not dead, in Connecticut and Tennessee. The pattern of enactments may be those recently set in Vermont and Missouri (where tax increases are subject to voter approval). Both increase personal income taxes with an emphasis on high income individuals, a progressive move. Both increase the sales tax, a regressive move. Both increase taxes on cigarettes and/or alcoholic beverages, a highly regressive move.

Other Perspectives On Taxes: As decisions on tax policy are made in some of the larger states, they will probably follow the same pragmatic responses found in Vermont and Missouri. This isn't because state officials are deliberately deciding to have regressive tax systems. Other factors come into play, including popular preferences for sales taxes and some excises over income taxes.

Table 6: Highest And Lowest Taxes On Three Income Groups

Low Income Taxpayers			Middle Inc. Taxpayers		Richest Taxpayers	
Rank	State	Rate	State	Rate	State	Rate
1	Washington	17.4%	New York	13.9%	New York	11.3%
2	Texas	17.1	Wisconsin	13.4	California	10.6
3	Nebraska	16.9	Nebraska	11.5	Maine	10.2
4	Connecticut	16.5	Michigan	11.4	Oregon	9.9
5	Illinois	16.5	Rhode Island	11.4	Hawaii	9.8
6	South Dakota	16.2	Massachusetts	11.3	New Jersey	9.7
7	Pennsylvania	15.9	Utah	11.2	Rhode Island	9.6
8	New Jersey	15.2	Maryland	10.9	Minnesota	9.6
9	Tennessee	15.2	Illinois	10.8	Ohio	9.6
10	Indiana	14.8	New Jersey	10.8	Vermont	9.6
41	Nevada	10.0%	Alabama	8.5%	Alabama	5.1%
42	Oregon	9.8	Texas	8.4	New Hampshire	3.8
43	Minnesota	9.5	Tennessee	7.7	Tennessee	3.6
44	Wyoming	9.0	Florida	7.6	South Dakota	3.5
45	Hawaii	8.7	New Hampshire	7.6	Washington	3.4
46	Maryland	8.0	Montana	7.4	Texas	3.1
47	Delaware	7.4	Delaware	7.0	Florida	2.7
48	Vermont	7.4	Nevada	5.7	Alaska	2.5
49	Montana	7.1	Wyoming	5.3	Wyoming	2.4
50	Alaska	5.3	Alaska	3.1	Nevada	1.8

South Carolina's Assessment: A recent tax study report in South Carolina, besides offering an example of a quality review of a state's tax policy, illustrates the range of considerations other than regressivity that affect decisions on taxes. The 158-page report assesses South Carolina policy systematically against the principles for state revenue systems developed by a NCSL task force in 1987. The report suggests the state will have difficulty in capturing two major growing sources of economic activity. To eliminate this concern, it suggests broadening the sales tax base to services and the income tax base to some retirement income. In recognition that South Carolina is no longer a rural/agricultural state, it suggests strengthening the role of local revenues including giving school boards more flexibility in raising property taxes. For cities and counties, it proposes adding alternatives to the local option sales tax, including a local piggyback income tax and local motor vehicle taxes.

HEALTH CARE ISSUES

State Plans To Expand Health Care Access: In April, Governor Castle (DE) briefed a Congressional committee on the Governors' Association work on health care, which is expected to lead to policies for the governors to adopt in their meeting in August. The governors hope to have something constructive to say about reform at the federal level and to outline some options for state policy. Some of those are designed to cut the overall costs of health care: (1) "managed" care, (2) tort reform, and (3) all-payor fee setting arrangements resulting in the same payments for the same service by Medicaid, private health plans, and private patients. Many of the recommendations being considered are designed to shift costs from a narrow base to a broader one. One example is spreading high-cost coverage over all insurers, as is now done in risk pools in auto insurance.

This hasn't been a year for enactment of new programs to expand health care for the uninsured, except as necessary to comply with federal mandates to expand Medicaid coverage. But the level of legislative concern, and frustration, remains high. One indicator came in April in Missouri. The House health committee brought a Canadian-style health plan to the floor. The plan had features opposed by many involved in health care politics, like substituting the state for others as the buyer of care for everyone. It also had a stiff tax, 7.5% of payroll. Notwithstanding these features, the bill garnered 63 votes to an opposing 86. A measure to create a Health Care Commission with extensive regulatory powers passed the Florida House, but emerged from conference committee and passed as establishing a working group charged with making a study.

Federal Action On Health Care: Health care concerns in Congress mount along with health care costs and perceived problems, but no action appears likely anytime soon. Speculation about federal action presumes no action on any of the national health care proposals before the elections of 1992.

Limiting Malpractice Costs: The Bush Administration has announced it will push legislation to control medical malpractice costs. The draft legislation unambiguously takes positions on tort law issues now in the hands of state legislatures. The policies favored include: (1) limits on pain and suffering awards, (2) "structured settlements," rather than lump sum payments to victims, and (3) pre-litigation mechanisms like arbitration. Under the legislation, the federal government would set standards for the operation of medical licensing boards. Trial lawyers objected because they don't like the proposals. State officials were concerned about preemption of their authority and financial penalties if they don't comply with the federal mandates. Hospital officials worried that states wouldn't follow the guidelines and the penalties would be extracted from them.

Federal Medicaid Costs: Fixed cost-sharing percentages mean federal Medicaid costs move in lockstep with state costs. So it wasn't surprising that OMB Director Darman expressed concern that the federal costs were "exploding." He cited growth in the federal share from a previously estimated $40 billion to more like $50 billion in federal FY 1991 and a further escalation in FY 1992 to almost $65 billion. He announced a crash study to determine what was causing the growth. Much of the emphasis appears to be in predicting the cost increases more accurately, rather than in preventing the cost increases.

There isn't any secret about Medicaid cost escalation. State officials have experienced several years of it. They have extensive data on who the recipients were, who the vendors were, what the costs per case were, etc. The primary reasons for cost increases: (1) increasing recipients for many reasons including recession, federal mandates of coverage, and extended coverage of AFDC providing automatic Medicaid coverage, (2) escalation in the cost per unit of service, such as hospital days, and (3) more extensive service such as greater use of expensive tests. State officials have underestimated these factors. Costs have also been underestimated systematically in some states (e.g., California, Michigan, New York) to show balanced budgets and in expressions of hope that various cost control measures would work. To the extent that federal budget officials have relied on the state estimates, these state misestimates have become federal misestimates as well.

It is unlikely that any of the factors affecting the Medicaid estimates has been unknown to federal officials who work with Medicaid. So there is some concern among state officials that the federal mini-study may have something to do with restrictions on Medicaid bootstrap financing (see next article).

As the federal investigation of the causes of cost increases was getting underway, a federal decision further increased cost. Clozapine, a drug to treat schizophrenia at a cost of $6,000 a year, is now part of the Medicaid drug program nationwide.

Non-Medicaid Free Care Pools: The many arrangements developed by individual states to pay for unreimbursed hospital care are tending to become unhinged. The costs involved are those incurred by hospitals and not recovered from patients, insurers, or government programs such as Medicare and Medicaid. They consist of costs for the uninsured and portions of costs for insured persons that are represented by deductibles or not covered under the policies involved.

In Florida, one of the major issues this year was whether to provide for added financing requirements by a tax on hospital services, "a sick tax" as opponents see it, or a general tax of some sort such as motor vehicle fees. The result was a compromise, involving a little of each. In New Jersey, the legislature refused to renew a surcharge of about 19% on all hospital bills. As a result, each hospital has its own surcharge. Surcharges add more than 50% to the bills of some urban hospitals but less than the previous 19% to hospitals serving more affluent areas. Predictably, consumers are beginning to respond by directing business to the hospitals with the lower surcharges. Certain union health and welfare funds are initiating litigation over hospital charges, arguing that federal Employee Retirement Security (ERISA) legislation precludes state policies which lead to large surcharges.

In Massachusetts, the high costs and rapid growth of the "free care/bad debt pool" were two of the factors leading to passage of the universal care legislation in 1988. That law included a cap on the size of the pool. With universal care down the tubes, the governor has recommended removing the cap. The action would make consumers, primarily employer health plans, pay an extra $79 million a year through their hospital rates.

Medicaid As A Middle Class Benefit: The extent to which Medicaid has become a portion of retirement and health care planning for higher income Americans is indicated by a Business Week (5/20) feature, "Before You Settle On A Retirement Community." The article discusses long-term care (nursing home) insurance policies, noting they "cost a pretty penny." It then notes that personal financial planners can help find alternatives and quotes a tax attorney who "recommends transferring assets to a child or other trustee so you can meet the net-worth limits for Medicaid." A similar article appeared in the Wall Street Journal (5/23) with citations to books like The Medicaid Planning Handbook and Avoiding The Medicaid Trap. Some of the devices, like irrevocable trusts, are complex. Others are simple. For example, entering a nursing home with a $200,000 house, a $100,000 mortgage, and $100,000 in investments requires the liquidating of the stocks to pay the nursing home before Medicaid eligibility can be established. But using the investments to pay off the mortgage first protects their value, because there is an exemption for homes in Medicaid's asset test.

Connecticut has long had an expensive approach to nursing home care under Medicaid, paying an average of $109 a day, fourth highest in the nation. State law mandates that care be identical regardless of whether Medicaid or private funds pay the bill. According to the New York Times (5/14), nursing home operators say this removes incentives for people to pay their own way, "Why give up a lifetime of savings if it makes no difference in care?" The state has tried to cope by limiting the number of nursing home beds, but this has created waiting lists and illegal side payments to gain admission. The new budget seeks to cut costs by limiting reimbursement rates to care defined as essential in medical terms, reducing, for example, the number of recreational programs.

Medicaid Solutions: New York's comptroller recently suggested that the state deal with its Medicaid problems by having an independent commission run the program. He argues:

> This nearly three-decades-old multi-headed budget-busing monster must be removed from the hands of a crazy-quilt bureaucracy and the political decisionmaking process if it is to be brought under control. Drastic action is needed now before Medicaid wrecks our public finances and our health system as well.

For the larger states, it is much too early to tell how the mandated growth in Medicaid services will be paid for. Overall, it will be a difficult-to-quantify mixture of (1) higher taxes, (2) lower spending for other programs than would have been the case without the mandates, and (3) reductions elsewhere in Medicaid. The trade-off is relatively clear in Utah, which has already enacted its budget for FY 1992. The mandates will add young children and pregnant women whose incomes are above welfare levels. The money to serve them is being made available by eliminating about 3,000 adults who have slightly too much income to receive cash assistance. Other Medicaid recipients will find Utah is dropping optional services so they will have to pay for their own hearing aids, glasses, and dentistry.

MEDICAID BOOTSTRAP FINANCING

Medicaid Cost Shifting: The federal inquiry on Medicaid costs raises the question of whether there is more than just improving cost predictions on the federal agenda, such as attempting to revive proposals to shift more of Medicaid costs to the states. Administration attempts to shift costs were common in budgets of the 1980s, but consistently rejected by the Congress. The substance of the plans was to have a greater percentage of costs paid by states. The mechanics varied from proposal to proposal.

Bootstrap Financing: One new issue may become the hottest federal-state fiscal issue of 1991 and 1992 -- the practice **Reports** calls Medicaid "bootstrap financing." The National Conference of State Legislatures calls it "states' use of provider taxes and voluntary contributions to enhance state Medicaid matching funds." NCSL concludes in its Federal Update (5/24) that the Administration has launched "a major offensive" against the practice.

In simple terms, a health care provider puts up the state share of Medicaid costs. It earns a federal share and both shares are returned to the provider. The arrangements differ in whether the contributions are voluntary or compulsory, the numbers of types of providers involved, and whether the money is "laundered." If providers contribute to a fund that is used directly to obtain the federal match with contributions proportional to Medicaid business, the tie is most direct. If a tax is involved independent of Medicaid business (e.g., 3% of hospital gross revenue) and the money goes to a state's general fund, the tie is highly indirect.

Rapid Growth Of The New Financing Plans: Making a long story short, federal officials have long taken the position that voluntary contributions couldn't be used as a Medicaid match. A few states (e.g., Tennessee) pioneered in bootstrap financing devices. Other states expressed interest, but federal officials were arguing with states using the procedure over disallowing their claimed match. Congress has placed a moratorium on disallowances, good through 1991. The moratorium, budget pressures, and the apparent success of states that tried the device led to spreading use.

The Health and Human Services Inspector General calculates the federal loss from "creative" state schemes at $2.5 billion in this fiscal year. State officials using the practice defend it on the merits and as a way to deal with their desperate fiscal problems caused by rising costs, caused in part by federal mandates. HealthWeek (5/20) described the situation as, "States Outfox Feds For Medicaid Cash."

Current Use Of Bootstrap Financing: According to the Health Care Financing Administration, bootstrap financing is costing about $2.5 billion in federal funds, about five times as much as in FY 1990. The practice is concentrated in a few states as shown in Table 7.

Table 7: Federal Costs Of Medicaid Bootstrap Financing, FY 1991

	Federal Cost ($ million)	
State	Donations	Provider Taxes
Massachusetts	$307	
Pennsylvania	292	
Alabama	288	
Texas	244	
Tennessee	224	
Kentucky		$221
Florida		189
South Carolina		161
Missouri	130	
North Carolina	110	
New York		102
California	68	
Ohio		65
Georgia	56	
Maryland		28
Hawaii		1
Washington	*	
Idaho	*	

* Less Than $1 Million.

Rapid Expansion Of The Financing Plans: Adopting bootstrap financing arrangements where they don't exist and expanding them where they do is one of the major efforts to reduce net Medicaid state costs being considered in the legislatures this year. They have already been adopted in some states (e.g., Arkansas and Maryland) with projections of budget balance based on their anticipated effects.

Bootstrap financing plans are pending in many legislatures as ways to solve budget problems. In Massachusetts, the governor has been assuring a nervous treasurer and the public that the state won't have to borrow during FY 1991 because of an expected payment of $489 million in Medicaid reimbursements. In Oregon, legislators and the governor are considering a tax on hospitals or all health care providers to raise the extra money for their Medicaid plan revisions. Both houses of the Alabama legislature have passed a dedicated tax covering hospitals, nursing homes, and prescription drugs.

The Illinois Hospital Association is pushing for revisions in hospital reimbursement that would cost an estimated $300 million annually. The plan is being sold to the Illinois legislature as costless -- the hospitals put up $150 million which triggers federal matching funds for the other $150 million.

Ohio And The Coming Collision: Ohio provides an example of what is developing in the industrial states and its implications for Medicaid financing nationwide. It also illustrates why and how the states are quickly forcing a major federal decision. Ohio is just an example. There are similar moves afoot in other states.

The governor has proposed a budget premised on no major tax increases and a balanced budget. Many legislators don't like the spending consequences, such as eliminating general assistance, but don't want tax increases either -- or want them but don't think they can get them enacted. Ohio already has bootstrap financing at a relatively modest level, based on an 0.5% levy on hospitals. It is seen as drawing an extra $50 million of federal Medicaid match. After initial reservations, the Ohio Hospital Association likes the idea. The chairman of the House health committee has a bill to expand the arrangement, upping the tax to a maximum of 5% and covering other health care providers. The estimated impact is $400 million more in Medicaid match. The idea looks so good that it is likely to be incorporated in the House budget legislation, making it possible to continue the general assistance program.

Ohio has about 4.4% of the nation's population. If other states take similar action, the national result would be about 23 times Ohio's $400 million or a total federal tab of around $9 billion. This has obvious budget implications for the federal government. It also has the state and federal policy implication of making the Medicaid program more extensive than it would otherwise be. For states like Ohio, the consequences of any federal policy that rejects this type of match after January 1, 1992 are substantial as well.

EMPLOYEE BENEFITS

Calculating the employer costs of benefits provided to workers in all state and local governments is a time-consuming task. The Census Bureau has just released its results for 1987 as part of the 1987 Census of Governments. The data in Government Costs For Employee Benefits are somewhat dated, but the relative generosity of state and local benefits is likely to be stable over time. Table 8 shows the percentage of payroll in each state represented by employee benefits, particularly Social Security and retirement contributions and health insurance plans.

Table 8: Costs Of Employee Benefit Plans As Percent Of Payroll
State And Local Governments, October 1987

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New York	29.5%	15	Tennessee	23.2%	34	Iowa	19.4%
2	Pennsylvania	29.2	19	Ohio	23.0	35	Arizona	19.3
3	Connecticut	27.6	19	Wyoming	23.0	36	New Hampshire	19.2
4	Maryland	27.4		**United States**	**22.8**	37	Arkansas	19.1
5	Utah	26.9	21	Florida	22.6	38	Colorado	18.9
6	Delaware	26.4	22	North Carolina	22.4	38	Nebraska	18.9
7	Hawaii	25.5	23	New Jersey	22.2	40	Illinois	18.6
8	Rhode Island	25.0	23	West Virginia	22.2	41	South Dakota	18.4
9	Oregon	24.8	25	Virginia	21.9	42	Missouri	18.3
9	Wisconsin	24.8	26	Oklahoma	21.8	43	North Dakota	18.1
11	Washington	23.9	27	Alabama	21.6	44	Kansas	18.0
12	California	23.8	28	Montana	20.6	45	Mississippi	17.8
13	Nevada	23.5	29	Minnesota	20.5	45	Texas	17.8
14	Massachusetts	23.4	30	Vermont	20.2	47	New Mexico	17.3
15	Alaska	23.2	31	South Carolina	20.1	48	Indiana	17.1
15	Maine	23.2	32	Georgia	19.9	49	Kentucky	16.5
15	Michigan	23.2	33	Idaho	19.5	50	Louisiana	16.1

Considered in conjunction with information on employee cash compensation (States In Profile, Table E-19), these data suggest that states where wages are high also have expensive benefit plans. By comparison with other states, they are doubly expensive because (1) costs are higher as a percentage of wages and (2) wages are higher. For example, New York is third highest in average state and local pay and also first in costs of benefit plans shown in Table 8. Connecticut is fourth in wages and third in benefit plans. The converse is also true. Benefit costs are low percentages of wages in Arkansas, Mississippi, and South Dakota. In these states, the benefits cost a lower percentage of the lower wage, so per-employee costs are considerably lower.

MISCELLANY

Economic Development: Asked to identify the state's #1 problem, 38% of Michigan respondents picked the economy/jobs, up from 19% last October. Crime/ drugs was second (18% down from 30% in October) and education third (13% down from 19%).

Federal Preemption: There is a sizeable collection of bills with serious chances of passage by the Congress that preempt state and/or local laws on various subjects. The proposed Surface Transportation Assistance Act of 1991 limits state authority in trucking regulation as well as regulating, through grants, state highway department operations. The President has made a new proposal that would require states to conform to federal policy in their medical malpractice laws. The proposed revisions of interstate banking laws preempt state branch banking regulation.

State-Local Fiscal Relations: Robert Strauss (Carnegie-Mellon U.) discusses "State-Local Finance: Rethinking Service Delivery and Taxing Authority," in NCSL's Fiscal Letter (March/April). He offers several principles such as having the level of government responsible for financing a service set benefit levels. Taxpayers and legislatures have set up another set of principles in tax and expenditure limits. These are assessed statistically by Philip Joyce (Congressional Budget Office) and Daniel Mullins (Indiana U.) in the Public Administration Review (May/June). They conclude that the limits on states have had little effect. Limits on local governments seem to have had the effect of encouraging state aid. This is consistent with attempts to raise local restrictions in states from Alabama to Massachusetts.

Wetlands: State policies for dealing with wetlands and the ecological and federal regulatory climate influencing the policy choices are the topic of Wetlands Protection And The States (National Conference of State Legislatures). The 26-page summary finds examples of regulatory programs in Florida, Michigan, New Jersey, North Carolina, North Dakota, and Virginia. Some states have acquired wetlands and there are special property tax concessions for landowners preserving wetlands in Iowa, Minnesota, and New Hampshire.

Items: The heavy involvement of some state pension funds in takeover activities of Kohlberg, Kravis, Roberts & Company is the subject of "Gambling With The Big Boys" in The New York Times Magazine (5/5). Author Sarah Bartlett, who has written a book on KKR operations questions "whether public pension funds should be investing in such high-risk deals." She does make a case that KKR made considerable money, thereby reducing returns to the participating pension funds, but doesn't suggest the pension fund returns were below alternative investments. States mentioned for heavy involvement are Illinois, Iowa, Massachusetts, Michigan, Minnesota, Montana, New York, Oregon, Utah, Washington, and Wisconsin.

The Kansas involvement in risky investments caused the governor to appoint herself to the retirement system board earlier this year. She has now decided to resign based on changes in investment administration she finds acceptable.

When awards for landing on your feet are given, the former superintendent of the Richmond (CA) district that declared bankruptcy will probably be a winner. Walter Marks was associated with the district's overspending (as well as the innovative education programs for which the money was used). He got a severance payment of $93,990 to buy out his contract and a new job running the Kansas City schools. The award for not landing on your feet was given by the Federation of Tax Administrators to the Massachusetts Department of Revenue for "excellence, creativity, and innovation." The award was for handling administration of the state's extension of the sales tax to services -- a law which was repealed retroactively after being in effect for a few days.

The Florida legislature passed several bills this year with purposes that aren't obvious from the bills' provisions. One permits prostitutes to sue their pimps to get back earnings pimps take by coercion. A reasonable guess is that without the bill courts wouldn't entertain such suits because the money was illegally obtained in the first place. Then there was the bill passed to make it illegal to impersonate a state legislator. **Reports** is not aware of how widespread this problem is or of the adverse public consequences flowing from such impersonations. Perhaps some Florida legislator found a solution to having to be in two places at once and his colleagues didn't like it. Or maybe local comedians were doing impersonations. Or maybe ???

TECHNICAL NOTES

State Budget Developments: The Michigan poll was done for Public Sector Consultants (300 S. Washington Sq., Lansing, MI 48933). The tax revenue survey is from the Center for the Study of the States (Rockefeller Institute of Government, 411 State St., Albany, NY 12203). The complete data appear in its State Revenue Reports (May). The 50-state version of Table 1 appears in State Budget & Tax News (Issue 12).

Crime And Corrections: The inmate and incarceration statistics are from the Justice Department's release "Prisoners In 1990." The statistics include some federal prisoners while excluding prisoners sentenced for under one year who are found in local jails in most states but in state prisons in some circumstances.

State Tax Policy: The Citizens for Tax Justice (1311 L St., NW, Washington, DC 20005) report is titled A Far Cry From Fair. The results for each state appear in Table A-1. The last three columns are the actual data presented in the study -- the percentage of income estimated to go to state and local taxes by residents of each state in each of the three income brackets. The summary is only part of the data in the study, which include average tax rate information for seven income brackets for 1985 as well as 1991. In addition, data for 1991 are presented for each income group for each state for each major tax (personal and corporate income, property, sales, and excise) along with the offsetting impact of deductibility of some taxes from income subject to federal tax.

There are varying ways of measuring regressivity and progressivity of taxes. These all involved some judgements beyond a conclusion that taxes should be progressive. For example, for a tax system to be progressive a household with income of $50,000 should pay more than twice as much tax as a household with an income of $25,000, but should it pay 2.1 times as much, or 2.2, or 2.3? CTJ avoided this problem by not using an overall measure, which tends to keep the study above criticism for arbitrariness, but makes it hard for decisionmakers to make comparisons with other states, unless they happen to be in one of the states CTJ calls the "terrible ten."

To make comparisons possible, **Reports** created an arbitrary but simple regressivity measure. Table A-1 ranks states on this measure, with the most regressive tax systems appearing highest. By counting from the bottom readers have a ranking based on progressivity. The third column shows the percentage by which the effective tax rate on low income persons exceeds that of middle income persons. For example, for the U.S. the 13.8% rate for low income persons is 38% higher than the 10% rate for middle income persons. If each group paid about the same effective rate, the third column would show zero, which is about what appears for New York (#42) Only six states have progressive tax systems in this comparison. Column 2 is the same calculation for rich and middle income taxpayers. Column 1 sums the two.

The tax study report, Financing Government In The Palmetto State, is from South Carolina's Advisory Commission on Intergovernmental Relations (P. O. Box 12395, 1333 Main St., Columbia, SC 29211).

Health Care: A fine summary of recent proposals for national health policies, including mandating expansion of Medicaid, takes up most of the May 15 issue of the Journal Of The American Medical Association. The American Association of Retired Persons (1909 K St., NW, Washington, DC 20049) has issued Reforming The Health Care System: State Profiles 1990. The 161-page publication is almost entirely devoted to three pages of statistics on each of the states, with comparisons to national averages. The U.S. General Accounting Office (Washington, DC 20548) has issued a new 57-page report, Health Insurance Coverage: A Profile Of The Uninsured In Selected States. The conclusions aren't surprising: "The likelihood of being uninsured in the United States is greater among young adults, minorities, unmarried people, and those with less than a high school education."

Table A-1: Effective State And Local Tax Rates, 1991

State		Total	Index Of Regressivity		Effective Tax Burden		
			Middle/Rich	Low/Middle	Low	Middle	Rich
1	Nevada	292	217	75	10.0%	5.7%	1.8%
2	Texas	274	171	104	17.1	8.4	3.1
3	Florida	263	181	82	13.8	7.6	2.7
4	Washington	262	179	83	17.4	9.5	3.4
5	South Dakota	235	148	86	16.2	8.7	3.5
6	Tennessee	211	114	97	15.2	7.7	3.6
7	Wyoming	191	121	70	9.0	5.3	2.4
8	New Hampshire	167	100	67	12.7	7.6	3.8
9	Pennsylvania	140	78	62	15.9	9.8	5.5
10	Illinois	133	80	53	16.5	10.8	6.0
11	Connecticut	115	42	74	16.5	9.5	6.7
12	Alabama	107	67	40	11.9	8.5	5.1
13	Indiana	102	52	49	14.8	9.9	6.5
14	Alaska	95	24	71	5.3	3.1	2.5
15	Louisiana	95	48	47	14.1	9.6	6.5
16	Missouri	94	52	43	13.0	9.1	6.0
17	North Dakota	91	35	56	13.3	8.5	6.3
18	Nebraska	81	34	47	16.9	11.5	8.6
19	Kansas	79	43	36	13.2	9.7	6.8
20	Mississippi	78	28	50	12.9	8.6	6.7
21	Michigan	75	50	25	14.3	11.4	7.6
22	Arizona	75	26	49	14.3	9.6	7.6
	United States	**70**	**32**	**38**	**13.8**	**10.0**	**7.6**
23	Colorado	64	45	19	11.0	9.3	6.4
24	Georgia	63	35	29	13.0	10.1	7.5
25	Arkansas	59	19	40	13.2	9.4	7.9
26	Oklahoma	59	38	21	12.2	10.1	7.3
27	Utah	59	36	22	13.7	11.2	8.2
28	Virginia	56	32	24	11.8	9.5	7.2
29	New Jersey	52	11	41	15.2	10.8	9.7
30	Iowa	52	22	30	12.5	9.6	7.9
31	Kentucky	50	25	25	12.5	10.0	8.0
32	Wisconsin	49	58	-8	12.3	13.4	8.5
33	New Mexico	49	9	39	13.1	9.4	8.6
34	Massachusetts	47	27	20	13.6	11.3	8.9
35	Rhode Island	43	19	25	14.2	11.4	9.6
36	California	43	-17	60	14.1	8.8	10.6
37	Idaho	42	9	33	12.8	9.6	8.8
38	West Virginia	40	1	39	12.9	9.3	9.2
39	Ohio	38	4	34	13.4	10.0	9.6
40	South Carolina	32	13	19	10.5	8.8	7.8
41	North Carolina	25	15	9	10.6	9.7	8.4
42	New York	24	23	1	14.1	13.9	11.3
43	Maine	24	-8	32	12.4	9.4	10.2
44	Maryland	8	34	-27	8.0	10.9	8.1
45	Montana	2	6	-4	7.1	7.4	7.0
46	Minnesota	0	9	-10	9.5	10.5	9.6
47	Oregon	-1	6	-7	9.8	10.5	9.9
48	Hawaii	-10	5	-16	8.7	10.3	9.8
49	Delaware	-11	-17	6	7.4	7.0	8.4
50	Vermont	-24	-4	-20	7.4	9.2	9.6

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June 1991 (Second of Two June Issues)

THE DEVELOPMENT IMPERATIVE

Assessing Development: While they work on the immediate problems of balancing state budgets, state officials are beginning to look more intently at the relationship between state policy and economic development. There is plenty of incentive to look. As unemployment and fears of unemployment become widespread, jobs and income soar in polls about public concerns, surpassing such issues as crime, the environment, and even taxes. As experts testify on the reasons why economic problems are driving revenues down and spending up, elected officials can see the advantage of solving budget problems by development rather than by either spending cuts or tax increases.

Development, The Painless Solution: From the perspective of state capitols, success in economic development has obvious appeal. Given a choice between getting 3% more revenue by 3% extra economic growth or a 3% tax increase, the political cost of the growth alternative is clearly less. So is the economic cost, because adding revenues by a growing economy doesn't take purchasing power away from current taxpayers. Economic growth is also a more comfortable social policy. In a stagnant economy, trying to find jobs for welfare recipients or new high school graduates isn't easy. In a vibrant economy, many of these people will find jobs with no government program. Growth is vital for social welfare spending as well, a point often made by Governor Cuomo in dealing with New York budgets. Attempts to increase social spending that require significantly higher taxes, he argues, tend to undermine the private sector growth that is ultimately the source of revenue to sustain state social programs.

Jobs And Recession: The recession has been taking its toll on jobs. Nationwide, from March 1990 to March 1991 there was a decline in the number of jobs. There were major differences among states as shown in Table 1. Nineteen states experienced job loss overall. The number grows to 22 if only private sector jobs are considered. A reasonable target for job growth is that it should reflect about the 1% annual increase in population. By that measure, only 19 states made the grade. Most of them are less populous states. Of the ten largest states, only Texas showed job growth of 1% or more.

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Table 1: Percentage Change In Employment, March, 1990 and 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nebraska	4.76%	18	Iowa	1.45%	34	Pennsylvania	-0.37%
2	Idaho	4.69	19	Montana	1.28	35	Maryland	-0.43
3	Utah	4.27	20	Oklahoma	0.97	36	Florida	-0.46
4	Nevada	4.11	21	Kansas	0.96	37	North Carolina	-0.54
5	Louisiana	3.01	22	Alabama	0.95	38	Missouri	-0.59
6	Washington	2.92	23	New Mexico	0.87	39	Georgia	-1.10
7	Arkansas	2.87	24	Wisconsin	0.78	40	Delaware	-1.16
8	South Dakota	2.79	25	South Carolina	0.74	41	Virginia	-1.48
9	Arizona	2.52	26	Mississippi	0.53	42	New York	-1.93
10	Colorado	2.39	27	Ohio	0.39	43	Connecticut	-2.00
11	North Dakota	2.24	28	West Virginia	0.24	44	New Jersey	-2.04
12	Alaska	2.08	29	Illinois	0.14	45	Michigan	-2.86
13	Hawaii	2.02	30	California	0.09	46	Vermont	-2.91
14	Wyoming	1.95	31	Minnesota	0.03	47	Rhode Island	-3.05
15	Oregon	1.59	32	Indiana	-0.10	48	Maine	-3.43
16	Texas	1.49		**United States**	**-0.12**	49	New Hampshire	-4.79
17	Kentucky	1.46	33	Tennessee	-0.29	50	Massachusetts	-4.93

Development Strategies: Most of the articles in this issue assess what is happening as state officials seek simultaneously to expand their development efforts, maintain their spending patterns for education and social services, and restrain tax increases.

A Strategy For Massachusetts: Massachusetts, with some of the worst economic problems in the nation, recently was offered a development plan by Harvard Business School professor Michael Porter. He joined legislators at a press conference to announce the proposals being incorporated in state legislation this year. Porter wrote The Competitive Advantage Of Nations which has attracted national attention for its discussion of American competitiveness. He also wrote a special report, The Competitive Advantage Of Massachusetts. It appeared in April, perfect timing to influence the omnibus budget legislation.

Porter's view of government's role rejects both a *laissez-faire* view in which the free market reigns and an industrial policy of government support for specific critical industries. He suggests, "Government's proper role is creating the *environment* in which firms compete." He sees state and local government as a powerful level because of influences on education, specialized training, and infrastructure, as well as taxes and regulation. Some of his specific recommendations are:

> *Get The Fiscal House In Order*: He calls dealing with the state deficit the first priority, noting, "Perhaps the most pernicious aspect is a lack of confidence which sends ripple effects

throughout the economy." He endorses productivity measurement, privatization, and priority for education spending. In the press conference, he said Massachusetts should be "the most fiscally conservative state in the union." This, he suggested, would attract capital, reduce the cost of borrowing, and restore and maintain confidence.

Encourage Investment: For private investment he endorses favorable tax treatment of capital gains and research and development credits. He suggests the state "sweep away the barriers to installing fiber optic, cellular, satellite, and/or other leading-edge communications capabilities which are the best of any state in the union."

Push Energy Conservation: He says the state should turn high energy costs into a strength, as Japan has. He urges the state become a model for the nation in environmental regulation.

INDEX OF STATE ECONOMIC MOMENTUM

The New Results: The West does best in the new Index of State Economic Momentum shown in Table 2. Every one of the top 15 states is West of the Mississippi River. Every one of the bottom ten is East of that dividing line.

Table 2: Index Of State Economic Momentum, June 1991

Rank	State	Index	Rank	State	Index	Rank	State	Index
1	Nevada	5.44	18	Florida	0.61	34	Indiana	-0.38
2	North Dakota	2.93	19	Maryland	0.52	35	Virginia	-0.39
3	South Dakota	2.65	20	Arkansas	0.50	36	Pennsylvania	-0.62
4	Washington	2.52	21	New Mexico	0.41	37	West Virginia	-0.73
5	Utah	2.48	22	Wisconsin	0.32	38	Tennessee	-0.74
6	Idaho	2.15	23	Kentucky	0.29	39	Missouri	-0.75
7	Alaska	2.02	24	Louisiana	0.23	40	Illinois	-0.98
8	Arizona	1.84	25	North Carolina	0.21	41	Connecticut	-1.00
9	Hawaii	1.66	26	Wyoming	0.10	42	New York	-1.01
10	Nebraska	1.16		**United States**	**0.00**	43	New Jersey	-1.14
11	California	1.14	27	Georgia	-0.14	44	Maine	-1.22
12	Oregon	1.12	28	Ohio	-0.21	45	Delaware	-1.28
13	Montana	1.12	29	Minnesota	-0.21	46	Rhode Island	-1.36
14	Texas	1.12	30	Alabama	-0.25	47	Michigan	-1.40
15	Colorado	0.83	31	Oklahoma	-0.31	48	Vermont	-1.60
16	South Carolina	0.81	32	Iowa	-0.35	49	Massachusetts	-1.87
17	Kansas	0.61	33	Mississippi	-0.38	50	New Hampshire	-2.50

The Index was developed by **Reports** as an up-to-date measure of how each state is doing economically relative to other states. It compares population growth, personal income change, and job growth. A high ranking indicates success in achieving economic development objectives and a state that is likely to be in a relatively strong fiscal position.

Keys To Success: The states which are doing much better than the national average have avoided massive recession effects by having something special going for them. Nevada is still experiencing a residential building boom while gambling industry employment holds up well. The Dakotas shot to the top of the Index because of federal farm support payments. Washington is living on success of key firms, like Boeing and Microsoft. Farm, ranch, and oil patch states are doing reasonably well. The Midwestern industrial states are suffering less in this recession than previous recessions, though Michigan has moved into the bottom five because of heavy job losses. Except for Michigan, all of the bottom ten states are in the Northeast.

Tax Increases And Economic Momentum: When national economic conditions are poor, more states adopt tax increases than in prosperous times. Because the Index ranks states *relative* to national conditions, it won't indicate the prevalence of poor state fiscal conditions. But it does suggest where they are worst. Of the ten states on the bottom, New Jersey adopted a major tax hike last year, seven states are clearly on the way to major tax increases this year, and two states (Massachusetts and Michigan) have governors trying against substantial odds to avoid increases. Tax increases aren't on the table in the top ten states in the Index excepting three with special situations: Nebraska (with the special property tax replacement problem described in this issue), Nevada, and South Dakota.

CORPORATE HEADQUARTERS LOCATIONS

Importance Of Headquarters: Having the headquarters of major corporations is a major advantage for a state. In addition to the favorable publicity they generate, headquarters operations are usually non-polluting and impose few demands on state and local government services. Other facilities, such as R&D centers, are often located near the headquarters. They generally employ a large well-paid staff which in turn provides a strong local tax base and a good source of active community leaders.

Counting Headquarters: Every Spring the major business periodicals publish their lists of the largest corporations in America. Each has its own definition of largest: Fortune (6/3) uses sales, Business Week (spring bonus issue) uses market value, and Forbes (4/29) compiles four separate rankings, using sales, net profits, assets, and market value. These firms are large -- the smallest firm on the

Fortune 500 Industrials list had assets of $116 million and sales of $546 million. Large well-established firms do not move their headquarters casually. Particularly in the last decade, changes in the make-up of these lists were often caused by mergers and acquisitions. As a result, states were more likely to gain headquarters by growing a company onto the lists of large firms than by a corporate move and to lose headquarters by merger or reorganization than by a relocation of an existing firm.

State Comparisons Of Headquarters: The list of states with the most headquarters is dominated by the larger industrial states. Using either Business Week's 1000 or Fortune's combined industrial and service lists, which total 1000, New York and California each have over 90 headquarters, followed by Illinois, Texas, Ohio and Pennsylvania with more than 60 each.

Tables 3 and 4 show the number of companies per million population in each state. Table 3 uses the combined Fortune rankings. Table 4 uses the Business Week list.

Table 3: Fortune Combined Service And Industrial 1000
Headquarters Per Million Population, 1991

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Connecticut	14.0	17	Arkansas	3.8	34	Iowa	1.8
2	Delaware	10.6	18	Hawaii	3.6	35	Utah	1.7
3	New York	7.5	19	Wisconsin	3.5	36	Florida	1.6
4	Minnesota	7.5	20	Indiana	3.4	37	Oklahoma	1.6
5	Illinois	7.3	21	Oregon	3.2	38	South Carolina	1.4
6	Rhode Island	6.0	22	California	3.2	39	West Virginia	1.1
7	Ohio	5.8	23	Washington	3.1	40	Kentucky	1.1
8	Massachusetts	5.3	24	Idaho	3.0	41	Maine	0.8
9	Missouri	5.2	25	Maryland	2.9	42	Mississippi	0.4
10	Pennsylvania	5.0	26	Colorado	2.7		Alaska	0
11	New Jersey	4.8	27	New Hampshire	2.7		Montana	0
12	Nebraska	4.4	28	Kansas	2.4		Nevada	0
13	Virginia	4.3	29	North Carolina	2.1		New Mexico	0
14	Georgia	4.1	30	Alabama	2.0		North Dakota	0
	United States	**4.0**	31	Arizona	1.9		South Dakota	0
15	Texas	3.9	32	Louisiana	1.9		Vermont	0
16	Michigan	3.8	33	Tennessee	1.8		Wyoming	0

Table 4: Business Week 1000 Headquarters Per Million Population

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Delaware	12.0	18	Rhode Island	4.0	34	Nebraska	2.5
2	Connecticut	10.9		**United States**	**4.0**	35	Maine	2.4
3	Illinois	6.6	19	California	3.6	36	Kansas	2.4
4	Minnesota	6.4	20	New Hampshire	3.6	37	North Carolina	2.1
5	New York	6.4	21	Hawaii	3.6	38	Tennessee	1.6
6	Idaho	5.9	22	Virginia	3.4	39	Kentucky	1.6
7	Ohio	5.9	23	Iowa	3.2	40	North Dakota	1.6
8	Massachusetts	5.8	24	Alabama	3.2	41	Florida	1.3
9	Pennsylvania	5.3	25	Oklahoma	3.2	42	Montana	1.2
10	Missouri	4.9	26	Michigan	3.0	43	Arizona	1.1
11	Georgia	4.6	27	Maryland	2.9	44	New Mexico	0.6
12	Oregon	4.6	28	Utah	2.9	45	Mississippi	0.4
13	Colorado	4.5	29	Indiana	2.9		Alaska	0
14	New Jersey	4.5	30	Wisconsin	2.8		South Dakota	0
15	Texas	4.2	31	Louisiana	2.6		Vermont	0
16	Nevada	4.1	32	South Carolina	2.6		West Virginia	0
17	Washington	4.1	33	Arkansas	2.5		Wyoming	0

About the same results appear whichever table is used. The long-established industrial states of the East and Midwest tend to lead in corporate locations. California and Texas are about in the middle of the pack. Rural states generally have few corporate headquarters; many have none.

Over short periods of time, the rankings are stable, as can be seen by comparing Table 4 with the comparable table for 1990 (*States In Profile*, Table B-18). Delaware and Connecticut switched places. New York dropped and Minnesota and Illinois moved up in rank.

But firms which are joining the roster for the first time aren't in exactly the same states as older firms. The *Fortune* 500 Industrials, the most widely-quoted ranking of firms, added 35 new firms located in 15 different states. Only 5 of the "big 6" states cited above were there -- Ohio had no new firms join the list. Connecticut, Minnesota, Nebraska, Washington, Michigan, Kansas, New Jersey, Wisconsin, Iowa and New Hampshire made up the rest of the newly added firms.

A different measure of a state's success at developing corporate headquarters is a list such as *Business Weeks*'s 100 "Hot Growth Companies" (5/27). These 100 fast-growing firms are located in 23 states. California leads the list with 22 firms, followed by Texas with 13. But states which are not well represented in the rankings of corporate giants appear here, including Minnesota (7), Colorado (5), Florida (4), and Georgia (4). Most states had none of these companies. Those that did have fast-growing firms are shown in Table 5.

Table 5: Business Week 100 Hot Companies Per Million Populatio

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Utah	1.7	9	New Hampshire	0.9	16	Oregon	0.4
2	Minnesota	1.6	10	Texas	0.8	17	Florida	0.3
3	Colorado	1.5	11	California	0.7	18	Pennsylvania	0.2
4	Massachusetts	1.3	12	Georgia	0.6	19	Louisiana	0.2
5	Nebraska	1.3	13	Tennessee	0.6	20	New York	0.2
6	Rhode Island	1.0	14	Arizona	0.5	21	Wisconsin	0.2
7	Oklahoma	0.9	15	Washington	0.4	22	Illinois	0.2
8	New Jersey	0.9		United States	0.4	23	Michigan	0.1

This listing is quite different from those of Tables 3 and 4. On Table 5 and similar listings are found states like Oregon, Utah, Minnesota, Massachusetts, and Texas as well as California.

Foreign Competition: These rankings consider only U. S. firms. As markets become more global, it is possible for a state to be doing well relative to other American states, but be doing poorly in world competition. Forbes compiled its four lists for the ten largest companies in the world. Using assets as a criterion, all ten are banks and none are American. Only three US firms make the list based on sales, four based on market value, and four based on profits. The dominant country on all of these lists except profits is Japan. Japanese banks account for nine of the ten largest asset-based firms (Barclays is the other). Japanese firms hold six spots on the sales list, five on the market value list, but only one (Toyota) on the profitability list.

THE DEVELOPMENT REPORT CARD

Why A Report Card?: The Corporation for Enterprise Development (777 North Capitol St., NE, Washington, DC 20002) has come a long way with its ranking system, The 1991 Development Report Card For The States. The report card concept began to give state policy makers an alternative to business climate studies that stressed low taxes and policies that discouraged unionization. The report card stressed fairness in tax policy, investments in infrastructure and education, and government policies of encouraging development. It tended to result in rankings which were directly opposite from the business climate rankings. One result has been to more or less eliminate simple conclusions about business climate from policy discussions, making the rankings more a subject for technicians.

The designers of the Report Card tried to keep their product simple. But there are now some 150 data elements entering rankings in four categories with multiple subcategories and several special analyses. The result is a bit more than the report card parents would expect children to bring home from school. Report Card is 156 pages, about 8,000 data elements, and comes with an electronic version requiring a reasonably expensive computer to run. {Many **Reports** readers have the capacity to handle this complexity and will find Report Card to be both interesting reading and a valuable resource.}

State Grades On The Report Card: There are four principal summary grades in the report reflecting performance on indices of: economic performance, business vitality, development capacity, and state policy. Table 6 shows the states that scored well by showing those with two or more grades of "A." The states with single "A" grades were Hawaii, Indiana, Iowa, Maine, Massachusetts, Michigan, Nevada, North Carolina, Ohio, and Pennsylvania.

Table 6: States With CfED Report Card Grades Of "A", 1991

"A's"	Performance	Vitality	Capacity	State Policy
4	Connecticut	Connecticut	Connecticut	Connecticut
4	Maryland	Maryland	Maryland	Maryland
3		California	California	California
3		Minnesota	Minnesota	Minnesota
3	New Jersey	New Jersey	New Jersey	
2		Colorado	Colorado	
2	Delaware		Delaware	
2	New Hampshire	New Hampshire		
2		New York		New York
2		Utah	Utah	
2	Washington		Washington	
2	Wisconsin			Wisconsin

The leading scorers are Northeastern industrial states and California. They benefit from the Northeastern economic prosperity that faded too late to affect the data used to measure performance and vitality. They also benefit from government policies assessed by CfED as being desirable, such as graduated income taxes. The losers, shown in Table 7, generally lack these policies. They are also states with economies that didn't perform well in the late 1980s.

Table 7: States With CfED Report Card Grades Of "F", 1991

"F's"	Performance	Vitality	Capacity	State Policy
4	Louisiana	Louisiana	Louisiana	Louisiana
3	West Virginia	West Virginia	West Virginia	
2	Kentucky		Kentucky	
2	Mississippi		Mississippi	
1			Arkansas	
1	Montana			
1				Nebraska
1				New Hampshire
1				New Mexico
1		North Dakota		
1		Oklahoma		
1				South Dakota
1		Wyoming		

STADIUMS AND ECONOMIC DEVELOPMENT

Introduction: Professional sports teams are getting major new concessions from cities and states. Governments are looking to hold the sports franchises they have while governments without franchises are trying to attract existing teams as well as new franchises. The situation leads to large public subsidies because towns (and states) seem to love their team more than their team loves their town. With the teams willing to move and the communities viewing keeping them as a matter of economic development as well as civic pride, the offers have escalated.

Critics Of Subsidies: There are some dissenters. New Jersey has aggressively worked to move teams from adjoining New York and Philadelphia, with success in moving New York teams to the Meadowlands. Philadelphia has kept its teams including the basketball 76ers and the hockey Flyers. A complex deal is afoot to satisfy both teams with a new arena. It would be privately financed but the state would spend $3 million to demolish an existing stadium. The facility would, under a recent state law, pay no property taxes for five years, and the city would provide a garage for arena parking. But the two candidates for Philadelphia mayor don't like the deal. One opposes the use of city funds for the garage. The other, former Mayor Frank Rizzo, commented:

> I am against funding anything in the area of sports. The owners of these teams are zillionaires. They've got all kinds of money, and they expect us to fund a new stadium. ... You can rest assured that they're not going to get any money from me.

The criticisms are not confined to Philadelphia. Gerald McEntee, the head of the American Federation of State, County and Municipal Workers, commented in Public Employee (June/July) on unnecessary spending that was taking resources from functions he considered more essential. His list of places to look for waste included contractors and consultants, special districts, and new construction -- "Are new sports arenas and convention centers and the like really essential right now or should we make sure that poor kids can be fed and vaccinated?"

Journalistic assessments tend to be critical, with titles suggesting the content of the articles -- "Take Me Out To The Cleaners," Business Week (5/6), "The Latest Municipal Malady: Convention Center Fever," New York Times (2/24), "Wrecking Ball Hits Convention Center Myths," City & State (2/11), and "City's Taxpayers Have Tiger By The Tail," Detroit News (12/23/90).

Academic assessments of cost-benefit analyses of stadiums also tend to be negative as typified by "Just Say No? The Economic And Political Realities Of A Small City's Investment In Minor League Baseball," Economic Development Quarterly, (May, 1991). Authors Mark Rosentraub and David Swindell (both Indiana University) talk of "big boys wanting big toys" at someone else's expense.

The criticisms extend to public marketplaces, often a part of convention center projects, as indicated by "After The Festival Is Over," Governing, (August, 1990). The article carries the subtitle: "Like Toledo, scores of cities have built glitzy festival marketplaces in an effort to cure downtown commercial blight. But in many of them, the cure isn't working very well." For convention centers, there is also criticism from trade groups of the use of public money to compete with private enterprise. In May, the International Communications Industries Association, the Exposition Service Contractors Association and the International Exhibitors Association criticized publicly supported centers for providing services available in the private sector.

Current Issues: One of the major debates over the Missouri budget this year concerned appropriating $5 million to contribute to construction of a domed stadium in St. Louis and sports facilities benefiting the Kansas City Royals (baseball) and Chiefs (football). In the Detroit area, the competition comes locally between the central city and the suburbs, as well as between the Detroit and other cities. The Tigers (baseball) want a new stadium at a cost of some $200 million. The Pistons (basketball) and Lions (football) already play in the suburbs. The Milwaukee Brewers are looking for money from Wisconsin to replace their stadium.

Other American league teams have gotten their deals already. The Chicago White Sox are in a new Comiskey Park and the Baltimore Orioles are expected to occupy their new stadium next year. Both were built with substantial government funding. Convention center support was an issue in Georgia this year, also in Missouri and other states.

Economic Assessments: The Heartland Institute has been active in assessing the economics of taxpayer support of convention centers, stadiums, and sports teams in a series of studies (see Technical Notes). While the conclusion is controversial, there appears to be a pattern for most projects. The economic feasibility assessments of the backers of major sports and convention center projects tend to be positive, even enthusiastic. The academic assessments tend to be negative. The operating results tend to be mixed, with cash flow often less than predicted but argument over the magnitude of indirect benefits (e.g., promoting tourism) and intangible benefits such as civic pride and "putting a community on the map."

Economically one would expect competition among states and cities vying for sports teams and convention business to drive down the cost teams and center users must pay for use of facilities. Who gets the resulting subsidy value isn't clear. Probably it results in lower costs for holding conventions, but in the case of sports events benefits may accrue to franchise owners as well as to sports fans. Whoever gets the subsidy value, it is true that the communities and states with the facilities will get the convention and sports traffic. The question is how much traffic is generated and how the money would otherwise have been spent.

The Politics of Stadium And Convention Center Subsidy: Regardless of the economics, these kinds of investments generate considerable enthusiasm among state officials. As the Governors' Bulletin described the situation in an enthusiastic article (8/90):

> The bases are loaded and the states are at bat swinging for high economic return for their investment dollars in sports complexes. More and more states are realizing the lucrative economic benefits that can be derived from investment in sports complexes. In many states, public financial investment in sports complexes is being viewed as an economic development tool.
>
> This kind of investment not only brings back dollars to the public coffers through direct economic impact but also can afford states a variety of indirect benefits such as: increasing national exposure, increasing tourism, offering a spirit of rejuvenation to economically depressed areas, and giving rise to an overall cultural renaissance.

COMPETITION IN TAX POLICY

Competition In Economic Development: Recession has meant there has been little activity in constructing new plants that would provide a basis for competition among the states. But the development competitors are in place, including an estimated 9,000 state and local development agencies. Finding a way to quantify whether the incentives being offered are growing would appear nearly impossible. But Time magazine in a feature on development (5/27) estimates that incentives are twice what they were ten years ago and that the average government price for a new job is $50,000.

Assessing Competition: Public finance experts have traditionally taken a dim view of the impact of competition for business on the national patterns of state fiscal policies. This view, reflected in a 1981 report, saw competition among the states as a zero-sum game. To the extent that states altered tax policies in the name of competition, the effect was likely to be lower taxes and thus lower spending. Tax policy was likely to be biased against taxes on businesses and taxes reflective of ability to pay, particularly graduated personal income taxes.

An alternative view is reflected in a new report by the federal Advisory Commission on Intergovernmental Relations, Interjurisdictional Tax And Policy Competition: Good Or Bad For The Federal System. The ACIR suggests that competition is less frowned upon than it was when its earlier report was issued. The report suggests that competition does serve as a regulator of state conduct. Among other things, it encourages investments in infrastructure and education and creates incentives to keep overall government costs down.

Competition And Tax Policy: The new report concludes that current research "confirms the tendency for interjurisdictional competition to reduce reliance on ability-to-pay taxes." It also notes continued criticism of state industrial development incentives through tax policy. But it cites research indicating that tax policies do affect business location decisions. It suggests that the "old model" of using economic development incentives may be changing. It says Colorado's economic development plan exemplifies "some of the more encouraging trends in state and local policies," such as moving away from an emphasis on industrial recruiting -- words obviously written before the competition for United Airlines began.

The United Airlines Competition: The competition for a United Airlines maintenance facility is hot. Oklahoma City has adopted a 1% sales tax to pay for its offer. Illinois and its local governments are reportedly offering $300 million.

The giant offer is one about to be offered to the Colorado legislature. The plan offers credits of $500 to $2,000 per year per employee. While not called a subsidy in local debate, the tax credits would result in cash payments from the state to the airline in years when the credits exceeded the company's tax liability. A substantial debate has developed over whether granting the tax concessions would be cost effective.

Tax Incentives In Massachusetts: Massachusetts is in the poorest position of any state to consider tax cuts. Its credit rating is the worst in the nation. Its voters only narrowly defeated a ballot measure last November to roll back taxes. Its pension plans are about the most underfunded in the nation. Its pre-FY 1991 budget imbalances were turned into debt, with interest and principal burdening current budgets. Its FY 1991 budget is out of balance. Its FY 1992 budget is way out of balance and the governor is pledged to block tax increases. So if Massachusetts elected officials are considering tax cuts, there must be a reasonably compelling case at least as they see the situation.

This spring the governor proposed several tax cuts to encourage business. The major proposals would provide credits for investment and for research and development that corporations could offset against their income tax liabilities. The governor decided that he wouldn't press for enactment this year in light of the fiscal situation. In May, the House Ways and Means Chairman unveiled the legislative alternative to the governor's budget. It called for tax credits for research and development as well as less specific commitments to eliminate unnecessary business regulation, spur innovation, and to put Massachusetts in the forefront in providing business incentives. With support from the governor and legislative leaders, some version of business incentives like these would appear to have a good chance of passage this year and an excellent chance within the next several years.

Tax Incentives In Maine: New business tax credits to spur investment were also recently proposed by Maine's governor. The fiscal climate for them was in one way even less favorable than in Massachusetts. In Massachusetts, the proposals were criticized as not being affordable and providing business tax breaks when the Commonwealth was cutting its help for the poor. These criticisms apply in Maine along with one more. Unlike Massachusetts, the Maine proposals are part of a package raising taxes, including the sales tax. One way of looking at the package is that new taxes on average Maine residents were being levied to finance tax breaks for Maine corporations. But the Republican governor's investment credit proposals "have won unusually warm support from Democratic legislators," according to Maine's leading newspaper. Similar proposals have been made by Maine Democratic leaders in the past.

Tax Incentives In Missouri: Missouri also offered new tax concessions for development in the same session in which it raised taxes on individuals and corporations. The new law authorizes 18 new enterprise zones, adding to the 39 already established since Missouri started using them in 1982.

STATE FINANCES IN POOR SHAPE

Overview: The fiscal circumstances of most states deteriorated seriously all spring. Monthly revenue reports showed tax revenues running below estimates, even those estimates that had already been revised downward. Lagging revenues at the end of FY 1991 encouraged estimators to revise downward their projections for FY 1992 revenues. While revenues dropped, spending escalated with rising costs in Medicaid and corrections and failure of cost cutting measures, like hiring freezes, to bring the savings anticipated.

The result appeared in dramatic revisions of fiscal projections. California's estimated budget gap moved from the $7 billion announced in January to $12.6 billion in the early spring to $14 billion in May. Similar revisions were made in other states with budget bills pending, such as Delaware, Maine, and Pennsylvania. In some of the states with budgets already enacted, such as Florida, the revisions triggered new actions to attempt to bring budgets back in balance.

Recovery And State Budgets: The critical question in building the FY 1992 budgets is how quickly the recession will end and how robust the recovery will be. The continuing passage of time without signs of recovery is causing some state officials to recast their assumptions. This was the basis for Governor Casey's decision to up the size of his proposed Pennsylvania tax increase. As he put it:

> A recession which was forecast by economic experts just months ago to be mild, shallow, and brief is no longer being described in these terms. Based on our actual tax receipts so far, we see no hope for substantial improvement in the near term.

Late Budgets: One impact of the bad news has been to delay budget decisions. Some legislators were unwilling to vote for the cuts that would be required to enact a balanced budget without major tax increases. Others were unwilling to vote for the tax increases to avoid the cuts. The combination of these forces sometimes precluded pulling together a working majority to pass a budget and tax package. The task is even more difficult in states where extra-large majorities are required to pass the budget (e.g., California) or enact emergency clauses so tax measures can go into effect quickly. As a result, states like California, Massachusetts, and Vermont missed informal deadlines for early enactment of their budgets -- deadlines related to the need to get revenues from tax increases and savings from budget cuts flowing quickly.

As New York passed June 1 without a budget, it was setting new records for extending the process beyond the April 1 beginning of its fiscal year. Other states may have this problem, such as California, which missed its deadlines last year, and Illinois where there is talk of a long hot summer.

Consequences Of Late Budgets: Questions arise when late budgets become a possibility. These are the common ones and the answers.

How common is going past the beginning of a fiscal year? In the 1980s, the federal government often didn't adopt budgets on time. It sometimes went an entire fiscal year without final budgets for some agencies. In 1983, all federal agencies operated on continuing resolutions, with no final budget ever enacted. The states act much more rapidly, but going beyond the beginning of the fiscal year by up to a week occurs in a few states every year. Occasionally states go longer. For example, Ohio didn't adopt its final budget until late December of 1971, halfway through the fiscal year in which it made the controversial decision to adopt an income tax.

Is it legal? Federal and state constitutions have provisions saying in substance that no money shall be spent except pursuant to appropriation. In some states and at the federal level, ancient statutes and presumed emergency powers provide some credence to the claim that some outlays (e.g., keeping prison guards on the job) can be made as emergencies, but most of the claims are weak. In interim periods before budgets are enacted, the states and federal government enact appropriations bills for short periods known as continuing resolutions or emergency appropriations. Sometimes players essential to enactment of an appropriations bill -- the governor or leaders of one house -- deny approval for these bills to increase pressure for passage of the final measure. Then the press reports the state has "run out of money." Actually it has run out of appropriation authority.

What are the disadvantages? If a state were operating with stable tax and spending policy, the only disadvantage would be uncertainty about the final budget outcome and the public perception that state elected officials couldn't get their work done on time. If the new budget is to include tax increases, the state loses revenue from delayed enactment. Other consequences -- benefits of employee pay raises, savings from spending cuts, starts of new projects and programs -- are also delayed. Special problems arise, as they did in New York and could in Massachusetts and Pennsylvania, when the state or a major local government needs to go to the financial markets.

What would make legislatures act in time? Timely legislative action is most likely when the end of the legislative session is set constitutionally well before the end of the fiscal year, primarily a practice of the less populous states.

Pressures For Tax Increases: The deteriorating fiscal circumstances of many states have clearly upped the pressures for major tax increases. Decisions by three governors provide examples.

In Maine, Governor McKernan (R) had consistently maintained Maine could operate without any tax increase despite its economy which mirrored the rest of New England. He recently recanted in a big way, proposing increases in many Maine taxes, suggesting increases in business aid and public works spending, and rejecting some budget cuts he had previously endorsed. Governor Ashcroft (R) in his opening message to the Missouri legislature opposed tax hikes with a possible exception for education reform. Presented with solid legislative support for increases, he entered the negotiations to reduce the size of the hikes and add education reform, then endorsed the resulting package. In Pennsylvania, Governor Casey (D), who campaigned in 1990 on the basis of no tax increases, proposed increases in January but avoided broad based taxes. He recently upped the ante with a proposal for a major income tax increase.

How Large Will State Tax Increases Be? There will be no systematic compilation of state tax increases until the National Conference of State Legislatures publishes its traditional preliminary one in August. Even then, it will be hard to assess the year because some states -- such as Florida, Tennessee, and Texas -- may be acting in August or later for various reasons. The current guess among state fiscal experts is that the total annual yield of state tax increases enacted this year will be around $17 billion. This is a large number: (1) about the same as the first year revenue from the federal tax increase of 1990, (2) over $65 per capita, (3) nearly $150 for every American worker, and (4) over a 5% increase in state general fund taxes.

Fatherless Taxes: Concern over being responsible for tax increases has added to the popularity of the tax for which no elected official is responsible. Such taxes have been rare in state fiscal history, but the device is becoming more popular. One common example is the minimum school property tax required for participation in state aid. Georgia provides an example of state action to raise this local tax. The Texas school legislation achieves this result in a complex way by creating new regional taxing districts. South Carolina has a local option sales tax for counties that redistributes money among counties much as a state tax would do. To avoid a state tax, which the governor opposed, but raise state purchasing power for highways, which many Floridians wanted, Florida last year adopted a local option gas tax that really isn't optional. This year Minnesota adopted a local option surcharge on the sales tax. The option not to levy it is linked with the option to lose all state aid.

Local Tax Increases: One consequence of fiscal problems at the state level will be fiscal problems at the local level. Some states will shift their difficulties by aid cuts as well as more subtle means, such as limiting the flow of prisoners from local jails to state prisons. The impacts of state actions will often compound difficulties in local finances stemming from other causes, such as economic downturn. The shifting is most obvious in Massachusetts and New York. The new budget legislation in New York makes cuts below prior year levels in both aid for schools and aid to cities and counties. In Massachusetts, there have been delays in making state payments to local government, cuts in past years, and more cuts contemplated in the current budget.

Avoiding local aid cuts and the perceived property tax increases that go with them has been an objective of those considering tax increases in some states. This was a major motivation of the tax bill passed in Kansas, which was vetoed by the governor as not providing enough property tax relief.

Implications Of The Tax Increases: In every recession, tax burdens, measured as the percentage of personal income taken by state and local taxes, rises. The growth of tax revenue drops as income and sales lag, but property taxes remain steady or rise and governments tend to raise tax rates as they are doing this year. While the taxes rise, personal income rises more slowly. The tax burden statistic reflects a real burden for taxpayers who find their property and other taxes more burdensome to pay while unemployed or earning less income. But, for the taxpayer, there has traditionally been relief with economic recovery. While personal incomes rise sharply, taxes rise less sharply and if 1984-85 is a guide, some states actually roll back some of their earlier tax increases.

Whether taxpayers will get the same relief when this recession ends isn't clear. Some of the tax increases are being offered with "temporary" components like the California sales tax proposal and part of the Vermont increase. But other tax increases are not, nor logically would they be in the many cases where they are offered as solutions to structural budget deficits (e.g., California), to finance permanent improvements in education (e.g., Arkansas and Missouri), or to shift burdens from local to state taxes (last year in Nebraska).

Mortgaging The Fiscal Future: The use of "one-time" measures will influence how many of the state tax increases will be temporary and will increase pressures for future tax increases. The one-time measures reap current savings or revenues at the expense of future costs or revenue flows. There is no way to quantify their use over 50 states. However, they seem to be extraordinarily popular this year.

Despite last year's disavowal of future non-recurring items, New York's new budget as proposed by the governor had $200 million in payments to the state from the transit agency serving New York City, over $100 million in accelerated tax collections, and over $100 million from selling state assets including selling the Aqueduct Race Track to the Port Authority. As enacted, the total is $625 million of one-time items, with bonding added to the list.

INCREASING GOVERNMENT'S SHARE

Government And Private Employment: Despite all the media coverage of financial hardships in government leading to layoffs, employment in the public sector is much more stable than private sector employment. This is shown by Table 8.

Table 8: Government And Private Employment Change, March 1990-1991

Sector	Employment (000)		Change	
	1990	1991	(000)	Percent
Private Sector	89,956	89,567	-389	-0.43%
Government Sector	18,586	18,844	258	1.39%
Total	108,542	108,411	-131	-0.12%

Responding To Recession, Individual States: The growth in public employment in states with the worst economic problems is large enough to be embarrassing to those seeking to demonstrate austerity in public spending. For example, New Hampshire and Rhode Island both expanded public employment by over 2% in the last year -- while private employment was dropping 4% in Rhode Island and 6% in New Hampshire.

Table 9, which was derived by **Reports** from federal data, shows sharp contrasts among the states in how employment change has occurred in both public and private sectors. The private employment change shown closely resembles the total employment change shown in Table 1. The difference is that government employment has been taken out of the total and shown separately, leaving private employment. Both are shown in Table 9 along with the difference between the two, which is a measure of how states are tracking private employment change with public employment change.

There is a tendency for public employment to remain stable or even grow a little reflecting population growth and new programs. Nationwide this led to growth of about 1.4% for the year ending in March. With a drop of 0.4% in private employment, the spread shown in the table is 1.8%. If government employment were constrained to match private employment changes, the spread would be zero.

Table 9: Percent Growth In Employment, March 1990 And 1991

Rank	State	Spread	Public	Private	Rank	State	Spread	Public	Private
1	New Hampshire	8.60%	2.54%	-6.06%	26	Indiana	1.32%	1.02%	-0.30%
2	Rhode Island	7.22	3.16	-4.06	27	Alabama	1.18	1.89	0.71
3	Nevada	6.50	9.80	3.30	28	Louisiana	1.17	3.94	2.77
4	South Carolina	6.20	5.78	-0.42	29	Wisconsin	1.16	1.76	0.60
5	Vermont	4.61	0.90	-3.71	30	Tennessee	0.72	0.31	-0.41
6	Florida	4.14	3.04	-1.10	31	Iowa	0.65	1.97	1.33
7	New Jersey	3.29	0.73	-2.56	32	Colorado	0.47	2.77	2.30
8	North Carolina	3.21	2.16	-1.06	33	Hawaii	0.38	2.32	1.94
9	Georgia	3.17	1.50	-1.67	34	Mississippi	0.25	0.72	0.47
10	Arizona	2.99	4.98	1.98	35	Pennsylvania	0.21	-0.19	-0.40
11	Michigan	2.89	-0.45	-3.33	36	Oklahoma	-0.05	0.93	0.98
12	Virginia	2.67	0.65	-2.02	37	Kansas	-0.24	0.77	1.01
13	Minnesota	2.42	2.05	-0.37	38	Kentucky	-0.65	0.94	1.58
14	Connecticut	2.41	0.09	-2.32	39	Illinois	-0.80	-0.54	0.26
15	Idaho	2.20	6.41	4.22	40	New Mexico	-0.83	0.26	1.09
16	California	2.14	1.88	-0.26	41	Arkansas	-0.95	2.09	3.04
17	Texas	2.09	3.20	1.10	42	Wyoming	-1.00	1.24	2.24
18	Maine	2.09	-1.73	-3.82	43	Nebraska	-1.18	3.81	4.99
	United States	**1.82**	**1.39**	**-.43**	44	West Virginia	-1.49	-0.94	0.55
19	Oregon	1.70	2.98	1.28	45	Delaware	-1.98	-2.86	-0.88
20	New York	1.62	-0.61	-2.22	46	South Dakota	-2.18	1.10	3.28
21	Maryland	1.59	0.85	-0.74	47	Montana	-2.26	-0.41	1.85
22	Massachusetts	1.58	-3.56	-5.14	48	Utah	-2.42	2.37	4.79
23	Washington	1.57	4.20	2.63	49	North Dakota	-3.41	-0.30	3.12
24	Ohio	1.44	1.61	0.17	50	Alaska	-3.87	-0.56	3.32
25	Missouri	1.37	0.56	-0.81					

If the numbers can be believed (see Technical Notes), the states at the top of the list have been expanding government jobs at the same time that private sector job markets have been contracting. This suggests that austerity hasn't affected government much. In New Hampshire, this is probably because so much of state and local employment is local employment financed by property taxes.

Nationwide, public jobs grew more than private ones in percentage terms in 35 states. Three situations were involved. First, in the most common case state and local employment grew while private employment declined. Second, in a few cases, like Nevada, both public and private jobs grew, but public ones grew faster. Third, in a few cases there were employment cutbacks in both public and private sectors, but the loss of jobs was greater in the private sector. This category includes some states with prominent fiscal problems that did affect state and local employment -- Michigan, Maine, New York, Massachusetts, and Pennsylvania.

The 15 states shown with a negative spread saw private employment grow more (or drop less) than state and local employment. This is a strong, but not conclusive, sign that these states will be avoiding future fiscal problems.

MISCELLANY

Bullet Trains: The Texas High-Speed Rail Authority has awarded a franchise to a consortium that expects to provide bullet train service connecting Dallas, San Antonio, and Houston. The $6.7 billion plan contemplates tax-exempt financing, but no state appropriations. The franchise doesn't guarantee construction, but gives the group a hunting license to bag financing. Bullet train systems have been discussed in other states, particularly Florida.

Income Taxes: Proposals for income taxes in states that don't have them haven't won acceptance anywhere, but some haven't lost either. The Connecticut legislature passed a bill emphasizing expanding the sales tax base as an alternative to the governor's income tax proposal. The governor vetoed it, with override considered unlikely. Florida's legislature has adjourned with minor tax increases but agreement that "tax reform" will be on the agenda for a special session later this year and/or next year's session. New Hampshire legislators are pursuing other alternatives, but having difficulty raising the money they think they need. Texas legislators will meet in the late summer to consider budget and tax issues.

Medicaid Bootstrap Financing: The idea of having health care providers pay the state share of Medicaid through contributions or earmarked taxes is spreading rapidly. Officials of states that haven't been using the practice are asking why they shouldn't get on the bandwagon. An example was the discussion at the New Jersey Senate Revenue, Finance and Appropriations Committee budget hearing on Human Services in mid-May. The agency head said his staff was assessing use of the device to recoup money associated with the Uncompensated Care Trust Fund. One senator, quoting the legislative budget staff, suggested that an added $200-300 million a year could be tapped by the financing device.

In Pennsylvania, hospitals are going to be borrowing $365 million to make their contribution. Pennsylvania counties which run nursing homes are working on a borrowing pool to raise $173 million. Once put in motion, arrangements like these will be difficult to unwind. Federal decisions to disallow Medicaid reimbursements would be nearly tantamount to decisions to force state tax increases or major curtailment of Medicaid coverage. Probably for that reason, Gail Wilensky, head of the Health Care Financing Administration, is making a public case against bootstrap financing. She told the Philadelphia Inquirer (5/17), "What the states are doing ... is not right and ought not to occur." She indicated she wouldn't object if Congress wanted to increase the federal share of Medicaid costs, but "What I object to is this sort of under-the-table way the states are doing this .. It's bad public policy."

The consideration of the issue has apparently escalated within the federal government, with OMB a party to the decisions along with the Health Care Financing Administration. Expanding health care access argues for permitting bootstrap financing. Avoiding a sharp rise in federal outlays argues against. The major issue to be decided is whether to renew the legislative moratorium against regulations to prohibit the financing. A related issue is whether to allow Massachusetts to make retroactive claims. Massachusetts officials want quick reimbursement because the money, up to $489 million, is assumed as helping balance the FY 1991 budget and avoiding new borrowing. The legislative moratorium isn't scheduled to expire until the end of the year.

Nebraska Taxes: "New York is not Nebraska." former New York Senate Majority Leader Warren Anderson told the New York Times (6/2) as a way of explaining why it was hard to complete action on the New York budget on schedule. Nebraska probably does have it easier because the unicameral legislature means no conference committees. But in terms of tough issues and executive-legislative disagreements, Nebraska outranks most states by about any measure. Last year's passage of major tax hikes, the governor's veto, the veto override, and having the hikes considered and nearly rejected by the electorate provided more excitement than in the average state.

Now Nebraska officials fear local governments will lose all property tax revenues. Replacing them would require a doubling or tripling of the state sales tax or about doubling the income tax. The problem is complex and descriptions themselves controversial. Over the years, Nebraska like other states has granted exemptions (e.g., business inventories) to the property tax, primarily for personal property. Claiming under federal legislation prohibiting state tax discrimination against them, railroads, then pipelines and telephone companies got their taxes lowered. Now, claiming under the clause of the state constitution requiring uniformity in property taxes, four legislators on behalf of homeowners have sued. Their argument is that so many breaks have been provided to personal property that real property taxation is unconstitutional. The fact of the litigation, which is unlikely to be resolved quickly, means the property tax collections are uncertain.

In May, the governor suggested a special election to adopt an amendment to the state constitution. Resolving the issue is difficult substantively and politically because every alternative has differing ramifications for individual school districts and thus for individual households and businesses. The concept of the governor's plan is to exempt all personal property from taxes this year. Tax ideas on the table include a sales tax on farm and business utility purchases, reducing the fee retailers get for collecting the sales tax, a "depreciation surtax," and even raising sales and/or income taxes.

Property Tax Discrimination: Nebraska's problems won't necessarily prove unique to Nebraska, but won't be nationwide. They arise out of a common state, not federal, constitutional provision that property taxes be uniform for all property. Other states that have run afoul of this requirement have solved their problem by either restoring uniformity in assessments or amending their constitution to permit classification, with different assessment practices for different types of property.

The remedy of amending the state constitution isn't available if the constitution being violated by state property tax practice is the federal constitution. It contains no provisions on property taxes *per se*, but does have provisions on interstate commerce and an equal protection clause that sometimes has been held to protect economic as well as civil rights. The equal protection clause was at issue in an case (R.H. Macy v. Contra Costa County) which the U.S. Supreme Court recently agreed to hear. Under threat of boycott, Macy's withdrew. But the Court might accept companion cases presenting issues for California homeowners comparable to those involving California businesses. Another business parallel to Macy's is likely to reach the Court sooner or later.

In 1978, California adopted Proposition 13, an initiative designed to limit property taxes. It operates by limiting increases in assessed value except when property changes hands. The result is that neighbors have different assessments reflecting 1975 values for those still in the home they owned when Proposition 13 passed, 1985 values for those who bought ten years later, and 1991 values for those who buy this year. So neighbors in essentially identical houses may pay twice or even three times the taxes of other neighbors. Macy's has been competing since 1967 in the same mall as Penny's and Sears and paying about the same taxes until 1986 when Macy's underwent a corporate reorganization that was a change of ownership under California law. Now Macy's is assessed about $58 a square foot while its competitors are assessed about $21. Macy argues this is so unfair as to violate the U.S. Constitution.

California's formal freezing of assessed values until property changes hands is a rare practice. However, in some states informal procedures produce similar results. Properties are infrequently reassessed and assessors are not aggressive in pushing assessed values to full market values, but do move the assessed value to market values when properties are sold. It was this practice in West Virginia that caused the U.S. Supreme Court to find its procedures unconstitutional in a 1989 case.

TECHNICAL NOTES

Employment: The Bureau of Labor Statistics provides the monthly employment data used for Table 1 and assessed in Table 9. Government employment includes federal civilian employment, but it has been quite stable.

Economic Development: Porter's book on national competitiveness is available in regular book distribution channels. The version on Massachusetts was produced in collaboration with Monitor Company, Inc. (25 First St., Cambridge, MA 02141). Readers interested in detailed analyses of state incentives will find assessments of how the Midwestern states dealt with Japanese auto plant investments in Ernest Yanarella and William Green, eds, The Politics Of Industrial Recruitment (Greenwood Press, 1990).

Index Of Economic Momentum: The Index is produced by **Reports** every quarter. Each state's most recent one-year growth in personal income, population, and employment is related to the national average growth. The state's advantage (or disadvantage) is averaged for the three measures. Thus, the national score is zero. A state which exceeds national growth in each measure by 1% would have an index of +1. The underlying estimates permit calculations to two decimal points as shown in Tables 1 and 2. There are accuracy problems with each of the three estimates, so small differences among states in percentage change should be taken lightly.

Stadiums: The Heartland Institute (634 S. Wabash, Chicago, IL 60605) has published Should Governments Own Convention Centers? (1991), Sports Stadiums As "Wise Investments": An Evaluation (1990), Is There An Economic Rationale For Subsidizing Sports Stadiums? (1987), and Comparison Of Privately & Publicly Owned Sports Arenas And Stadiums (1985).

Competition And Tax Policy: The 1981 report was published by the Advisory Commission on Intergovernmental Relations, as Interstate Tax Competition.

Medicaid Bootstrap Financing: The June issue of State Legislatures has several important articles on state actions to handle Medicaid and deal with other health care issues. In one, NCSL staffer Tony Hutchison observes: "If historical trends continue, Medicaid costs will keep going up and spending more money will have only a marginal impact on the number of Americans covered. Most of the new money will be consumed by runaway medical costs and federal and judicial mandates that often just rearrange spending without addressing the central problems of the Medicaid program."

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July 1991 (First of Two July Issues)

STATE FINANCES AT RISK

Effects Of Fiscal Problems: State decisions this year are demonstrating how much is at stake when the state fiscal outlooks deteriorate.

> **Taxes:** Taxpayers will see tax increases in at least half the states with over 65% of the nation's population. The average worker will pay about $150 more in state taxes because of state legislative action this year.
>
> Actions to deal with state fiscal problems are also causing local tax increases. The effect is direct when states raise the minimum tax requirement in school foundation programs and use devices like Minnesota's mandatory optional local sales tax. Cuts in state aid will also produce incalculable, but substantial, local tax increases as local officials and voters opt to compensate for lower aid by higher taxes as well as by lower spending.
>
> **Public Schools:** Those interested in schools have watched new funding and reforms pass and then not be funded in Mississippi and be funded at a lower level than promised in many states. They have witnessed new reform proposals stall for lack of resources in states like Tennessee. In New Jersey, they have seen state action to take back some of the money previously set aside for education. In many states, state funding for schools hasn't increased to match inflation. In Massachusetts, New York, Rhode Island, and elsewhere it has been cut.
>
> **Higher Education:** Those interested in higher education are experiencing continuation-type budgets, presuming little or no expansion of existing programs and lacking new initiatives. The financing for these budgets is coming from tuition increases of nearly 10%. In some states, universities have been subjected to mid-year cutbacks, more than once in states such as Massachusetts and Virginia. In some states, universities are responding by making it tougher to gain admission and restricting the courses available.

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Health: Those interested in health have seen Medicaid gobble up resources while programs oriented toward prevention and mental health share austere conditions with the rest of state government. Those involved with Medicaid have encountered a constant stream of cost-cutting proposals, most of which don't seem to have worked. The cost-cutting that works, at least in the short term, has been cutting provider reimbursements or at least refusing increases, then cutting the value of the payments by delays in making them.

Social Services: Those interested in social services have seen cash assistance payments under AFDC frozen in most states. In California for AFDC and in many states (e.g., Massachusetts, Ohio) for general assistance, there are proposals to reduce eligibility and/or cut payment amounts. Growing caseloads in the context of desires to limit the growth rate in social service spending have put considerable pressure on spending for other forms of social service. Housing programs, programs to get welfare recipients off welfare through training, and child welfare services have been feeling the fiscal pinch.

Local Government: Local officials have seen the impacts of state fiscal problems in many different ways. The most obvious have been cuts in state aid to local governments as in Massachusetts, Minnesota, and Virginia. Also indirect state aid through tax expenditures to relieve burdens of the property tax are under attack in California, Illinois, Minnesota, and elsewhere. Adverse state fiscal conditions have cut off possible new aid that might have been provided by states to deal with city fiscal problems like those of Bridgeport, Chelsea, New York City, and Philadelphia.

State Workers: State employees have been hard hit by promotion freezes, small or no raises, larger required contributions to health insurance, and, in a few states, furloughs and layoffs. They have also been affected by decisions deferring paydays and restricting travel and by the uncertainties that have affected their working environment.

Other: There have been other programmatic impacts of austerity, such as state support of the arts and staffing of state parks. Sometimes decisions made in several contexts have a substantial cumulative overall impact, such as on library systems supported by both direct state operations and state grants.

Causes And Cures: Without doubt, the magnitude of the current state fiscal problems is associated with national economic recession. It hit immediately following the 1990 elections, catching many states with FY 1991 budgets that had been optimistic about revenues and spending and heavy on one-time items to avoid tax increases or major spending cuts before the election.

Besides recession, some states were affected by special situations. One was the systematic imbalance of revenue and spending known as structural deficits which clearly exist in some states like California and Massachusetts. Such deficits arguably exist in other states, but definitely not in all. Another was decisions to expand spending for reasons other than balancing the budget. Examples: the enacted tax increase in Arkansas for education and the failed proposal in Kansas for property tax relief. The third was dealing with school finance reform court decisions, which will be the primary reason for tax action in Texas.

There is disagreement within individual states and nationally about the extent to which states will have to raise taxes or cut back existing programs to deal with the realities of the 1990s. Steven Gold in The State Fiscal Agenda For The 1990s (NCSL, 1990) argues that states will probably have to increase taxes through the decade. Others (including **Reports** editor Hal Hovey) see increasing state taxes as a percentage of personal income as a choice which state officials will be able to make either way. No one really knows. Whether states will have to raise taxes in the 1990s to maintain existing programs depends upon such unpredictable factors as federal mandates and the growth rate of the economy.

Risks In The Next Twelve Months: Regardless of the longer term outlook, the states face some massive risks during FY 1992. There are a few offsetting possibilities for gains, such as a dramatic and quick recovery from recession, but not much possibility for good news appears on the horizon. The potentials for bad news that would place major strains on state finances include: (1) continuing recession, (2) new federal mandates, (3) restrictions on Medicaid bootstrap financing, (4) school finance litigation and attempts to forestal it, and (5) refunds of taxes paid by federal retirees.

This list doesn't include the serious financial contingencies affecting only one or two states. Past examples include Rhode Island's bailout of financial institutions, California's response to earthquake, and South Carolina's reaction to Hurricane Hugo. That such contingencies will appear in some states is predicable, though what contingencies will appear in which states isn't. In addition, there are future fiscal problems built into some past decisions, such as replacing property taxes in Oregon as required by citizen initiative and dealing with property taxes in Nebraska as required by past court decisions.

More Recession: The conventional economic wisdom being used in state forecasts is typified by the DRI estimates used in the June forecasts of the Illinois Economic and Fiscal Commission. They reflect real GNP growth of 2.1% in FY 1992 (July 1991 through June 1992) versus the negligible growth of 0.1% in FY 1991. On a calendar year basis, the GNP growth in the California Commission on State Finance forecast is 3.0% for 1992, a major improvement over -0.1% in 1991 and 1.0% in 1990. The group's pessimistic alternative to these forecasts assumes a delay of one quarter in recovery, which would drop state revenues by $1.5 billion.

New Federal Mandates: Strenuous state and local objections to mandates and the obvious financial distress in the state and local sector may be encouraging restraint in new federal mandates, though this remains to be seen. The National Conference of State Legislatures is continuing to maintain a list of pending mandate proposals. The list is growing as Members of Congress increasingly recognize that last year's federal budget agreement essentially precludes using grants to influence state and local decisions. This leaves them with the choice of doing nothing on subjects they consider important or introducing legislation backing mandates.

Restrictions On Medicaid Bootstrap Financing: As discussed elsewhere in this issue, many states have seized upon health care provider donations and earmarked taxes as a major portion of the solution for balancing FY 1992 budgets. Massachusetts has used a nationally publicized recovery of nearly $500 million to balance its FY 1991 budget. As a result, FY 1992 bootstrap financing claims could easily amount to $6-8 billion. ***There is a good chance that federal officials will challenge many of these claims,*** particularly after the Congressional moratorium on disallowance expires in December. Disallowance is a double risk. States would lose the revenues they had counted on in FY 1992 and be stuck with the expenditure patterns without the revenue in FY 1993. Some states, such as Indiana, have made their provider reimbursement obligations contingent on the federal allowance, but not all have done so.

School Finance Litigation: As discussed in this issue, school finance cases are active in many states, including New Jersey where officials encountered considerable criticism for their tax increases to fix the problem. In the states facing litigation, elected officials have been reluctant to take state aid away from some districts, thereby triggering the local choice of tax increases or program cuts. Absent action to take from the richer districts to fund more aid to poorer ones, the amounts required to achieve equalization don't fit within current state revenues, even when times are good. Kentucky's tax increases provide an example of what can happen, with Texas soon to debate following this pattern.

Refunds Of Federal Retiree Taxes: The issues associated with past tax payments declared illegally discriminatory against federal employees and retirees in the Davis case are still in litigation. Resolution could bring bad news for the states involved, which have been accruing interest bills on top of the claims. Missouri, which acted immediately to make refunds, needed a temporary tax increase just for this purpose.

Deferred Problems: Many of the budget-balancing resolutions this year have put problems into the future. They include borrowing from other funds or from the public, sale of assets which have to be leased back, deferral of maintenance and equipment purchases, acceleration of revenues, the future costs of early retirement plans, and more. Some of these are classic "one-time" items as they are traditionally called in New York. The spending pattern continues the following year, but the one-time financing doesn't. So financing the spending requires tax increases, sharp cuts in other programs, or another round of one-time items. The supply of these isn't inexhaustible.

Conclusion: All the factors are in place for continuing difficulties in state finances, and thus for all the programs listed at the beginning of this article. The outcome is critically dependent upon the national economy. But state policy will make some difference, particularly determination to control the factors that have in the past several years caused large overruns of budgets for corrections and Medicaid.

EDUCATION ISSUES

Introduction: With most state officials looking to avoid or minimize tax increases, education funding is taking a beating this year, at least by the standards of the late 1980s. School funding is more generous in the few states with money to spend without raising taxes because they have avoided most recession impacts. Education funding is also rising rapidly in two special circumstances: (1) major increases associated with education funding equalization, and (2) new education quality initiatives and their associated tax increases.

School Funding Levels: There continue to be large disparities among the states in school spending. The latest estimates of per pupil spending from the National Education Association appear in Table 1.

The disparities among states are large by just about any measure. The highest state (New York) spends over three times as much per pupil as the lowest state (Utah). Three states exceed the national average by more than 50%. Four states would have to increase their spending by more than 50% to reach the national average.

Teacher Salaries: One of the key factors leading to differences in per pupil costs is teacher salaries. So, it is not surprising that the leaders in spending tend to lead in salaries as shown in Table 2.

Table 1: Expenditures Per Pupil In Attendance, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	New York	$8,680	18	Michigan	$5,257	34	New Mexico	$4,446
2	Connecticut	8,455	19	Wyoming	5,255	35	Indiana	4,398
3	New Jersey	8,451		**United States**	**5,208**	36	Kentucky	4,390
4	Rhode Island	6,989	20	Illinois	5,062	37	Texas	4,326
5	Alaska	6,952	21	Kansas	5,044	38	Arizona	4,196
6	Pennsylvania	6,534	22	Washington	5,042	39	Nebraska	4,080
7	Massachusetts	6,351	23	Hawaii	5,008	40	Louisiana	4,041
8	Maryland	6,184	24	Florida	5,003	41	South Carolina	3,843
9	Delaware	6,016	25	Iowa	4,877	42	Oklahoma	3,835
10	Wisconsin	5,946	26	Georgia	4,852	43	South Dakota	3,730
11	Maine	5,894	27	California	4,826	44	Tennessee	3,707
12	Vermont	5,740	28	Montana	4,794	45	North Dakota	3,685
13	New Hampshire	5,474	29	Colorado	4,702	46	Alabama	3,648
14	Minnesota	5,360	30	West Virginia	4,695	47	Arkansas	3,419
15	Virginia	5,335	31	Nevada	4,677	48	Mississippi	3,322
16	Oregon	5,291	32	North Carolina	4,635	49	Idaho	3,211
17	Ohio	5,269	33	Missouri	4,479	50	Utah	2,767

Table 2: Average Classroom Teacher Salary, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$43,861	17	Hawaii	$32,541	34	Texas	$28,321
2	Connecticut	43,847	18	Virginia	32,382	35	Tennessee	28,248
3	New York	41,600	19	Nevada	32,209	36	South Carolina	28,174
4	California	39,598	20	Oregon	32,200	37	Iowa	27,949
5	Maryland	38,806	21	Indiana	32,178	38	Alabama	27,300
6	New Jersey	38,790	22	Colorado	32,020	39	Nebraska	26,592
7	Michigan	37,682	23	New Hampshire	31,329	40	Louisiana	26,240
8	Rhode Island	37,674	24	Vermont	30,986	41	Montana	26,210
9	Massachusetts	36,090	25	Arizona	30,780	42	New Mexico	26,194
10	Pennsylvania	35,471	26	Florida	30,387	43	West Virginia	25,958
11	Delaware	35,200	27	Kansas	29,923	44	Idaho	25,485
12	Illinois	34,729	28	Kentucky	29,089	45	Utah	25,415
13	Minnesota	33,284	29	North Carolina	29,082	46	Oklahoma	24,649
14	Wisconsin	33,100	30	Wyoming	28,988	47	Mississippi	24,443
	United States	**33,015**	31	Georgia	28,855	48	North Dakota	23,578
15	Washington	32,975	32	Maine	28,700	49	Arkansas	23,040
16	Ohio	32,615	33	Missouri	28,607	50	South Dakota	22,363

Teacher salaries and spending per pupil are roughly correlated with per capita income (with interesting exceptions noted below). They tend to be lowest in the states with the greatest inherent problems in financing schools: (1) a large number of children to educate in relation to population, (2) a growing student population, and (3) relatively low fiscal capacity. States like Utah, Arkansas, and Mississippi fit this definition neatly. The ideal position for high per pupil spending and high salaries is found in the Northeast with a small number of children relative to total population, shrinking enrollment, and high fiscal capacity as measured by per capita income and other indicators. New York, New Jersey, and the New England states are examples.

Class Size: Average class sizes (States In Profile, Table G-17) follow predictable patterns, but have some notable exceptions. States with relatively low tax base per pupil -- that is low per capita income and a high ratio of school age students to population -- have the most strain in meeting national averages. So it is not surprising to find states like Utah (#1), Idaho (#4), and Alabama (#9) with larger-than-average class sizes. Likewise, states with high per capita income and a small percentage of school age children have low class sizes. Examples: Connecticut (#49), New Jersey (#47), and Massachusetts (#46). However, California has the second highest pupil-teacher ratio (22.7-1) in the nation, well above the national average (17.4-1). West Virginia, despite low per capita income, manages to maintain a 15.1 ratio, well below the national average.

Changes In Salaries: Many state elected officials have commitments to attempt to raise teacher salaries. Such commitments are particularly common in the South where salaries are low relative to national averages and state decisions set basic salary schedules. In the North, the salary decision is typically decentralized, though many states set minimum salaries and influence salaries in the ways in which they provide school aid. In any given year, history would lead to the expectation that salaries of teachers, other state and local employees, and private sector employees would rise slightly in excess of the inflation rate. For FY 1991 salaries, this would suggest an inflation rate of 4-5% (depending on whether one looks backward at past inflation or at predicted future inflation) plus an increment reflecting real personal income growth, of about 1%. The national average of a 5.4% increase for teacher salaries thus isn't surprising.

Not all states came close to this average as shown in Table 3.

Because the salary decision is decentralized, there often isn't a simple state policy explanation for differences among states in teacher salary gains. But state factors explain the extremely large and small gains. Top-ranked West Virginia had a statewide teacher strike, followed by a special session of the legislature that raised taxes specifically to fund increases. Kentucky and New Jersey both had major tax increases with improved state funding of local education a major rationale. Northern New England states were making their state and local decisions in the spring of 1990 before recession hit and when money was rolling in from statewide prosperity and rising property values. At the bottom, Mississippi made its teacher salary money dependent upon passage of a state tax plan that did not pass.

Table 3: Percentage Gain In Average Teacher Salary, FY 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	West Virginia	13.6%	18	Indiana	5.9%	34	New Mexico	4.3%
2	Kentucky	10.6	19	Delaware	5.5	35	California	4.2
3	New Jersey	8.7	20	Florida	5.5	36	Nebraska	4.2
4	Connecticut	8.4		**United States**	**5.4**	37	Colorado	4.1
5	Washington	8.3	21	Nevada	5.3	38	Kansas	4.1
6	New Hampshire	8.1	22	Missouri	5.1	39	Massachusetts	4.0
7	Louisiana	8.0	23	South Dakota	5.0	40	Wisconsin	3.7
8	Alabama	7.9	24	Arizona	4.7	41	South Carolina	3.5
9	Vermont	7.6	25	Michigan	4.6	42	Minnesota	3.4
10	Utah	7.3	26	Virginia	4.6	43	Arkansas	3.1
11	New York	6.9	27	Rhode Island	4.5	44	Georgia	3.0
12	Maine	6.8	28	Ohio	4.5	45	Texas	3.0
13	Idaho	6.8	29	Iowa	4.5	46	Wyoming	2.8
14	Oklahoma	6.8	30	Montana	4.5	47	North Dakota	2.4
15	Pennsylvania	6.4	31	Oregon	4.4	48	Alaska	1.6
16	Maryland	6.0	32	Tennessee	4.4	49	Hawaii	1.5
17	Illinois	5.9	33	North Carolina	4.3	50	Mississippi	0.3

New Assessment Of Student Achievement: The National Assessment of Education Progress recently released comparisons of math test scores of eighth graders in the 37 states that agreed to participate in national testing. The results are shown in Table 4.

Table 4: Average Eighth Grade Scores In Math, 1990

Rank	State	Score	Rank	State	Score	Rank	State	Score
1	North Dakota	281	18	Virginia	264	34	Alabama	252
2	Montana	280	19	Oklahoma	263	35	Hawaii	251
3	Iowa	278	20	Delaware	261	36	North Carolina	250
4	Minnesota	276		**United States**	**261**	37	Louisiana	246
5	Nebraska	276	21	New York	261		Alaska	
6	Wisconsin	274	22	Illinois	260		Kansas	
7	New Hampshire	273	23	Maryland	260		Maine	
8	Idaho	272	24	Rhode Island	260		Massachusetts	
9	Wyoming	272	25	Arizona	259		Mississippi	
10	Oregon	271	26	Georgia	258		Missouri	
11	Connecticut	270	27	Texas	258		Nevada	
12	New Jersey	269	28	Arkansas	256		South Carolina	
13	Colorado	267	29	California	256		South Dakota	
14	Indiana	267	30	Kentucky	256		Tennessee	
15	Pennsylvania	266	31	New Mexico	256		Utah	
16	Michigan	264	32	West Virginia	256		Vermont	
17	Ohio	264	33	Florida	255		Washington	

Education Secretary Lamar Alexander called the survey "an alarm bell that ought to ring all night." By his standards, "none of the states are cutting it." By one standard, only one seventh of the eighth graders tested did as well as should be expected. The states that did best, the Upper Midwest, rank high on most education indicators. There are demographic explanations associated with this outcome, such as a large percentage of rural population and a smaller percentage in poverty, but there are other explanations. For example, students of teachers majoring in math did better than those whose instructors majored in education.

Public Opinion on School Reform And Finance: A combined effort of Southern Opinion Research and the Birmingham News (4/14) yielded interesting contrasts between attitudes of legislators and Alabama citizens on school issues. Residents and legislators favored some school reform measures by large and similar margins. Examples: competence exams for teachers, making it easier to fire teachers, expanding preschool programs, increasing state funding of schools, and increasing required math and science courses. But they differed in other views as shown in Table 5.

Table 5: Views of Alabama Residents and Legislators, 1991

	Percent Agreeing	
Proposition	Residents	Legislators
Give more state money to poor districts than wealthy ones	83%	59%
Allow parents to choose which school children will attend	76	50
Raise the salaries of school teachers	68	83
Increase the length of the school year	24	63
Major problem in schools is not using money wisely	54	17

Alabama school finance is unique because a substantial share of state revenues is earmarked for support of education. Local support is low, 49th in the nation. It is discouraged by a prohibition against local school officials asking voters for additional money. An act of the legislature is required for the question of raising school taxes to be put to voters. Letting boards of education take proposed tax increases to voters was supported by more than 70% of residents and legislators. But letting local boards levy additional taxes without a public vote was supported by only a quarter of each. Various tax studies have suggested more use of property taxes for Alabama school finance. This was reflected by a 54% preference for property taxes (with 31% no opinion or no answer) from legislators asked which tax should be used if school funding were increased. Given the option of raising taxes on beer and cigarettes, 55% of residents picked sin taxes with property taxes drawing 19%, sales taxes getting 14%, and income taxes only 6%.

School Finance Equalization: "We're not going to let some court tell us how to fund our schools in Ohio, and we're going to do something about it," Ohio's Governor Voinovich promised an Akron audience shortly after his inauguration. In separate actions, Cleveland and a group of poor districts in the Appalachian portion of the state are preparing to litigate. The poor districts seek a classic equalization decision, like the Texas one. Cleveland, which isn't poor in tax base per pupil, seeks a more elaborate decision reflecting special problems of urban areas, like the New Jersey decision.

A select committee of the Ohio legislature has looked at equalization alternatives and arrived at mostly conventional recommendations. But it added a tax base sharing proposal that 50% of new business tax base be pooled in Cuyahoga County, which contains Cleveland and many smaller communities of varying wealth. The governor has endorsed pooling, which was a major feature of the Texas plan adopted this year. This is a difficult year for Ohio to try to reform its formula. The governor's determination to avoid tax hikes and pressures in other parts of the budget mean essentially no money for equalization plans, with school aid likely to rise less than 4% a year over the next two years. This leaves a choice of taking from the rich to give to the poor or doing nothing.

The Education Commission of the States recently published a readable 64-page review of Education Finance In the 1990s. Essays by Steven Gold (State University of New York), education formula consultant John Augenblick, and Kent McGuire (U. of Colorado) review topics like state versus local funding, school finance litigation, and the links between school quality initiatives and school aid formulas. The pamphlet includes tables detailing the status of school finance litigation in each state.

The economic case for school finance equalization is stronger in New Hampshire than elsewhere. The state divides its pupils and tax base into large numbers of small districts, with resulting large disparities in tax base per pupil. It eschews any major state aid program, with the current program confined to what the lottery will raise. This means the state program, though equalizing, can have little effect in offsetting major disparities.

A group of poorer districts began their litigation in June. The average district in New Hampshire has a tax base of $451,939 per pupil and an average tax rate of 0.92%, resulting in tax of just over $4,000 per pupil. The poorest district has a base of $106,950 per pupil while the richest has $17 million. If each levied the average tax, the poorest would raise $984 and the richest over $150,000. The issue is not whether these are large differences, but whether such differences violate the requirements of the New Hampshire constitution.

Special Education: Special education costs seem to be getting increasing attention from state and local officials. Federal programs provided impetus for extra funding and special treatment for a group of youth broadly defined as those with handicaps, mental or physical. This resulted in the intended consequence of extra programs (and cost) for these youth and an unintended consequence. School administrators and teachers could provide smaller classes and more materials for students if they defined them as needing special education. So the number of students so classified has tended to grow. In New York City, 22% of public school children are in this classification. An effort is being made to shift those not really needing the program back into regular classrooms. Comparative statistics among states or cities are indicative of how local practice affects results. For example, 83% of special education students in New York City are learning disabled and emotionally disturbed, a percentage well in excess of other large cities, particularly Atlanta with 38%.

Special education budgets are an example of diffused accountability in the federal system. Often there is an incentive at the school district, school, and classroom level to classify more and more children as special education children. Doing so triggers state and federal assistance not available if the children aren't so classified. But the classification also triggers a variety of rights under federal and often state law. So from the local level, the programs can appear exempt from budgetary scrutiny. For example, in examining New York's situation, the New York Times (4/30) reported, "Special education is protected against reductions by a web of state mandates and court rulings." Whether this statement is legally true isn't the only issue. If New York school officials believe it to be true and are not challenged by others, it is operationally true.

Rights to special education can have implications beyond special education students. The Richmond (CA) case (discussed last issue) was decided on the basis of one suit, but another was pending that also could have mandated the state to keep the schools open. It was brought on behalf of special education students, with the argument being that the state had a duty to keep schools open for them.

In Massachusetts, the state is responsible for substantial local costs because it requires local schools to provide special needs students with the "maximum feasible benefit." Governor Weld estimates that moving from this standard to the federal minimum standard would save local governments $54 million a year. In the legislature, the approach being offered is to keep the standard of care, but reduce the number of students identified for special education -- about 17% of all students compared to a national average of about 12%. In Pennsylvania, Governor Casey's budget proposals are designed to control what he has called "the runaway costs" of special education.

Similar actions are predicable in many states. Federal aid now defrays less than 10% of special education costs. No one believes that the 40% suggested by the original federal legislation will ever be reached. This puts considerable pressure on the states, particularly when state mandates seem to be driving local costs. In times of state fiscal stress, the tendency is to examine both the mandates and the costs.

Education Choice: Not much appears to be happening with the idea of student choice, though there is considerable activity in articles written, speeches given, and bills introduced. The President's education proposal, with $230 million for experiments in choice, is pending in the Congress with prospects uncertain.

The small New Hampshire community of Epsom attracted national attention when town selectmen adopted a policy of abating property taxes by $1,000 for those who send a pupil to private school rather than the town school. Selectmen argued they would save $3,000-4,000 per transfer. They got national publicity and litigation. The tax abatement approach follows the precedent of the Minnesota tuition tax credit, but involves substantially more money. An outright grant plan was introduced in the Pennsylvania legislature this year and probably in many others. Two Kansas legislators introduced legislation for Wichita modeled upon the Milwaukee plan. Massachusetts legislators passed a choice plan earlier this year, but work on the budget has overwhelmed work on implementing regulations.

For those looking for plans with a track record, there isn't much to go on except limited experience in Minnesota with choice among public schools. The litigation over choice plans is in various intermediate stages, providing little guidance on outcomes for plans adopted in other states.

HEALTH CARE

Introduction: Health care, other than financing Medicaid, hasn't been a major topic in the legislative sessions this year. There has been essentially no movement on state versions of universal care. The Massachusetts plan adopted in 1988 continues to have implementation postponed. The governor wants to take the law off the books, but legislators have been shifting the date, keeping it about two years away from the current year. Minnesota legislators adopted a demonstration program this year with an extra increase in the cigarette tax to fund it. The governor vetoed the tax and the plan on the grounds of incalculable future costs.

Medicaid Bootstrap Financing: One thing going for Pennsylvania in the Financial World rankings described in this issue is its "miraculous new Medicaid funding plan." The magazine explains:

> Donations from hospitals are used to apply for matching federal dollars. Then, money is cycled back to

> hospitals. No one loses except feds, budget director reports gleefully.

While the Pennsylvania write-up used "miraculous," the term used to describe Massachusetts' plan suggested magic. The story ran in many major newspapers, generally based on a front page New York Times (6/8) story combining human interest and state fiscal reporting. It began:

> After months of struggling to close Massachusetts's yawning budget deficit, Governor William F. Weld announced this week that the problem has been almost magically solved. Not by the state's 200 legislators. Not by his budget planners. But by a part time state employee who earns $22,000 a year.

The accomplishment is getting the federal government to kick in $489 million in dealing with the Massachusetts deficit for FY 1991 of about the same amount. The federal contribution is $81 per capita, making the total federal tab $20.2 billion if comparable payments were made to all states. Richard Nathan (State University of New York at Albany) commented, "This has become a new kind of big game hunt for state budget entrepreneurs." Forbes (7/8) talks of "a brand new pork barrel." It quotes the inspector general of the federal Department of Health and Human Services calling the growth of provider taxes and donation programs "like a virus spreading from state to state."

In Pennsylvania, the deal for nursing homes is being put together by the county commissioners' association (which gets a fee) because many counties are home operators. A hitch developed in late June when officials of two counties expressed reservations about participating, fearing that the federal government would later seek recovery. The Pennsylvania plan doesn't require cash provider donations, instead the money is being borrowed on behalf of the counties.

The count of states with operational bootstrap financing programs is now at least 25. In the new fiscal year, many more will be added. For example, Indiana has just adopted a program and Alabama has passed a new program with comprehensive taxes on Medicaid providers including hospitals, nursing homes, and pharmacies.

New Jersey Health Financing: "This is goring everybody's ox." That was the Speaker's summary of the legislation that barely passed the New Jersey Senate and was pending in the House in mid-June as proponents looked for enough votes to pass it. Opponents include the state Chamber of Commerce and the AFL-CIO. Proponents include the hospital association and the New Jersey Business and Industry Association.

Labor and management (excluding small business) appeared to have reached agreement last year on a comprehensive plan including a tax of over $1,000 per employee-year on firms not providing health insurance and over $100 per employee year on other firms. The plan floundered on opposition to the taxes and the state's inability to finance the added state spending on Medicaid vital to the plan's success. But legislators refused to renew the uncompensated care fund, which involved a tax of about 20% on hospital bills. Since January, individual hospitals have had their own uncompensated care surcharges, some as high as 50%. This provided an obvious inducement for consumers to use the lower surcharge hospitals. Clearly, some action was needed. The current 62-page bill is designed to reconstitute the fund with a new name and make other changes in the health care system.

The New Jersey fund bore some resemblance to the Massachusetts financing device used to recover nearly $500 million in bootstrap financing money from Medicaid. As of mid-June, the governor's lead person on health care financing wasn't making any commitments about future revenue from that source for New Jersey:

> We don't know if we are going to get the money. We don't know how much it is. We don't know what the needs are going to be so we are not making any comments or commitments or even discussions on what you do with money that you don't have.

Medicaid As An Upper Middle Class Benefit: Respectable publications continue to publish advice on how affluent people can protect their assets and get Medicaid. The example in the Wall Street Journal is a person with a home and $150,000 in liquid assets. The bottom line is that Medicaid (and the earnings on the assets) pay for nursing home care, but the heirs get the $150,000 free of any government attachment. The plan works even better for married persons.

STATE MANAGEMENT

Introduction: Last year Financial World presented a ranking of states based on their financial management. **Reports** was critical of the rankings on the grounds that neither the criteria nor the data on which they were based were spelled out. **Reports** and officials of some low-ranked states criticized some specific state results as being implausible. This year, with some changes in criteria, the magazine tried again in its May 28 issue.

The Rankings: Fourteen areas were examined in deriving the rankings, but with no indication of what weight was given each, whether the weighting varied from state to state, and no presentation of the numbers used and where they came from. As a result, the value and meaning of the outcomes are in doubt. It's like being called the best team in baseball without knowing whether the criterion was most games won, most hits, or best dressed. Winning such an award feels good, or at least better than losing it. In 1990, Governor Casey (PA) featured a favorable rating in TV spots in his successful reelection campaign. Winners can crow and the management of the losers will be criticized, but the World Series of state management the FW rankings are not.

This being said, the ratings do seem to have achieved the status of "reputational rankings," such as those used to assess universities for potential students. Such rankings can be said to have validity if they arrive at results similar to what other experts would produce if confronted with the same questions. The rankings appear in Table 6.

Table 6: Financial World Rankings Of State Management, 1991
Ranks Plus Standard & Poor's Bond Ratings

Rank	State	Rating	Rank	State	Rating	Rank	State	Rating
1	Utah	AAA	18	Georgia	AA+	35	Wyoming	*
2	Missouri	AAA	19	New Hampshire	AA+	36	Illinois	AA+
3	Maryland	AAA	20	New Jersey	AAA	37	Kentucky	AA
4	Virginia	AAA	21	Pennsylvania	AA-	38	Idaho	*
5	South Carolina	AAA	22	Alabama	AA	39	Oklahoma	AA
6	Tennessee	AA+	23	Mississippi	AA-	40	Kansas	*
7	Washington	AA	24	Louisiana	A	41	California	AAA
8	North Carolina	AAA	25	Colorado	*	42	North Dakota	AA
9	Minnesota	AA+	26	Michigan	AA	43	New York	A
10	Wisconsin	AA	27	Texas	AA	44	Rhode Island	AA
11	Indiana	*	28	Ohio	AA	45	New Mexico	AA
12	Iowa	*	29	Arizona	*	46	Connecticut	AA
13	Nevada	AA	30	Montana	AA-	47	West Virginia	A+
14	Florida	AA	31	Nebraska	*	48	Maine	AAA
15	Hawaii	AA	32	South Dakota	*	49	Vermont	AA
16	Delaware	AA+	33	Alaska	AA-	50	Massachusetts	BBB
17	Oregon	AA-	34	Arkansas	AA			

* No general obligation debt, thus no rating.

What Is Being Measured? Financial World doesn't indicate unambiguously what the rankings measure. Its cover lists the "10 best" and "10 worst." which could mean best place to retire, best place to start a business, or best state-supported child care system. The magazine's editor suggests state management is the criterion. The article mentions "good management skills coupled with efficient operations" and states "doing a particularly good or bad job" A short summary of how the rankings were derived discusses how well states "manage the resources available to them" and "the skill and efficiency with which states are run."

The criteria emphasize financial management, resembling some of the criteria for bond ratings, which themselves are one of the 14 criteria. States are well managed if their recent budgets show surpluses, large balances and rainy day funds are maintained, Medicaid payments aren't backlogged, and large unfunded pension obligations are avoided. Half the criteria involve processes to achieve these results by projecting revenues over a long period, accurately estimating revenue and spending, completing budget decisions on time, evaluating agency performance, having management controls for infrastructure, and maintaining award-winning accounting and auditing systems.

Rankings And Bond Ratings: As Table 6 suggests, there is a correlation between the FW rankings and S&P ratings. The worst state bond ranking belongs to Massachusetts, which gets last place from FW. Next lowest bond rankings are New York (#43 for FW), Louisiana (#24), and West Virginia (#47). The "AAA" states all rank in the top ten except three with current fiscal problems that affected their FW rating and may well affect their bond rating -- New Jersey (#20), California (#41), and Maine (#48). Maine subsequently was downgraded to AA+. On California, "Hard to feel sympathy for Californians. They created Frankenstein monster, then complain when he eats too much."

Rankings And Financial Management: Without explicit criteria, it is hard to say whether ratings are right or not. There are some anomalies. Being a high spending state hurts Vermont (#49), which is criticized for its welfare payment level, as well as other low ranked states. Most of the top ten are low spending states, but Maryland, Minnesota, and Wisconsin are in the group. Sometimes process overwhelms substance. Florida (#14) gets credit for projecting revenue to 2001 while Idaho and Nevada are faulted for not doing so. In practice, Florida revenues always fall short of spending plans which often isn't true in Idaho and Nevada. Maybe tough, conservative fiscal practices that prevent inadvertent tax increases because of overspending, overly optimistic revenue estimates, or pushing spending into future years should be the test. Many of FW's winners would make this list -- Utah (#1), Missouri (#2), Indiana (#11) -- as would some also-rans -- Nebraska (#31), Arkansas (#34), Oklahoma (#39), and North Dakota (#42).

How sophisticated a state's financial reporting, budget processes, and revenue estimating are doesn't necessarily correlate with financial management measured by avoiding debt, keeping reserves, or keeping low taxes. The award for sophisticated processes and staff work would go to the federal government. Processes in some states (e.g., California, New York, and Wisconsin) are sophisticated in this sense, but in functional terms others (e.g., Arkansas, Idaho, North Dakota) seem to get the job done.

LOTTERIES

State lotteries are now mature institutions. New Hampshire and New York have had them for over two decades. Other large state lotteries were generally established in the mid- to late-1980s, long enough ago so that their results can be compared without worrying about whether they are still gaining consumer acceptance. Table 7 does this, along with some lotteries from other developed nations.

Table 7: Total Lottery Sales Per Capita, 1990

Rank	State/Country	Sales	Rank	State/Country	Sales	Rank	State/Country	Sales
1	Massachusetts	$265.88		N.S.W. Australia	$78.64		Gr. Britain	$24.38
2	Maryland	171.59	16	Virginia	77.08	32	Minnesota	15.69
3	Connecticut	160.15	17	Arizona	76.77		Alabama	0
4	Florida	158.47	18	Vermont	76.61		Alaska	0
5	New Jersey	154.85	19	Indiana	72.63		Arkansas	0
	Quebec, Can.	154.50	20	Rhode Island	65.80		Georgia	0
6	Ohio	149.56	21	Idaho	65.35		Hawaii	0
7	Illinois	131.14	22	Wisconsin	63.72		Louisiana	0
8	Pennsylvania	130.46	23	Iowa	60.98		Mississippi	0
9	Michigan	128.93	24	Oregon	58.27		Nebraska	0
	Ontario, Can.	125.90		France	57.51		Nevada	0
10	New York	115.82	25	Kentucky	52.86		New Mexico	0
11	Delaware	99.10	26	Washington	52.85		North Carolina	0
12	South Dakota	91.69		Italy	46.48		North Dakota	0
	Germany	87.19	27	Missouri	43.04		Oklahoma	0
13	New Hampshire	85.79	28	Colorado	40.79		South Carolina	0
14	California	85.02	29	West Virginia	36.13		Tennessee	0
	Belgium	81.28	30	Montana	26.88		Texas	0
15	Maine	79.26	31	Kansas	25.90		Utah	0
	Ireland	79.12					Wyoming	0

Lotteries were an issue in some states this year, but not many. The lotteries are so well established in most larger states that the major issues associated with them were how to use proceeds. The tendency has been to convert lottery proceeds from an extra resource to part of the baseline resources for the regular state budget. This happened in New Hampshire several years ago with similar patterns now being followed in Ohio, Virginia, and probably other states. In states with lotteries, legislators are constantly asking why the yield can't be made higher and sometimes making proposals, like sports betting, for raising consumer interest and thus state revenues.

Establishing a lottery was an issue in some states. The plan appeared to have a reasonably good chance in Texas where the need for added state revenues was clear and the governor backed it. But it was defeated early in the legislative session. The decision could be reassessed when the legislature meets later this year to consider financial matters. Georgia's legislature approved a lottery proposal for submission to voters.

Table 7 suggests that the state lotteries in the United States have caught on with the public about as well as the major European and Canadian lotteries. It also shows major deviations among states in the success of state lotteries. There are many possible explanations for these differences, none totally convincing.

Several major professional sports leagues are pushing federal legislation to preempt state authority to legalize gambling on sports events through state lotteries. Citing state fiscal problems, Kansas State Representative Wanda Fuller testified for the National Conference of State Legislatures that Congress shouldn't restrict state revenue-raising options.

THE BANKRUPTCY SOLUTION

Fiscal Adversity And Its Remedies: Every year some of the 80,000 American local governments suffer serious adversity. Mines close in mining towns. Factories close in one-plant communities. Major uninsured losses occur. Treasurers make bad investments or abscond with money. Less serious adversity arises when the expectations of local officials for what they should spend don't conform with what taxpayers are willing to provide. The usual result, generally required by state law, is to adjust spending to conform with revenue. Occasionally, local officials will spend what they think is necessary and then close down when they run out of money. There are differing state procedures to deal with such situations, often involving some sort of receivership similar to what international labor unions use with their locals.

Recent Bankruptcy Filings: The Richmond (CA) school district got national publicity by a bankruptcy filing that is now being resolved by other means (Issue 12). In June, the City of Bridgeport filed for bankruptcy. Connecticut's attorney general is contesting the filing on the grounds that the city has no authority under state law to make such a filing. Bridgeport is already subject to state oversight through the state's Bridgeport Financial Review Board which resembles state oversight agencies used for Cleveland, New York City, Yonkers, and other jurisdictions. Whether the state or the city prevails depends upon interpretation of Connecticut state law on the powers of municipalities. Even if Connecticut prevails in the Bridgeport case, it is entirely possible that a municipality or county from another state could go the bankruptcy route.

What Will Bankruptcy Do? In broad terms the choices facing the Bridgeport council in its new budget were: (1) raise real property taxes 15-20%, (2) obtain apparently unobtainable concessions on compensation from city workers under circumstances where binding arbitration causes the bargaining environment to differ from most other communities, or (3) make major additional layoffs including garbage collectors and police officers. The bankruptcy filing was seen by many observers as an attempt to win labor concessions in order to avoid the other alternatives. In a bargaining environment of a bankruptcy, this could actually happen. In fact, some labor leaders said the mayor had unilaterally broken off negotiations that could have been fruitful. Bridgeport officials are explicit that they are not seeking to abrogate payment obligations to vendors or bondholders.

Viewed as an aid to labor negotiations, not many state or local officials are likely to pursue the bankruptcy route. It has substantial costs in diminished reputation of the jurisdiction (and thus economic development potential and citizen satisfaction), higher interest costs for borrowing, legal costs for the bankruptcy proceeding itself, and loss of control over the negotiating process. Whether there is a political cost to the elected officials involved remains to be seen.

How Does Bankruptcy Work? The classic bankruptcy case terminates the debtor (corporations) or gives the debtor a clean start (individuals) free of debt. The court allocates the remaining resources among the creditors. There are special bankruptcy procedures for corporations (Chapter 11 of the bankruptcy code) and governments (Chapter 9) where the intent is to retain the petitioner as a going concern.

In Chapter 11, the courts exercise extraordinary power on the grounds that they must do so to protect creditors who have a better chance of getting paid by a going concern than by one that simply folds. So airline creditors entitled to repossess airplanes are told they can't do so because the airline needs them to have a chance to pay off all debtors. Department store creditors entitled to a first lien on merchandise are told they can't seize merchandise delivered after the bankruptcy filing. Some of these principles may apply in the case of small municipal utility districts serving new housing developments, which is where much of the Chapter 9 experience has come.

It isn't obvious how these principles would apply in the case of a major municipality or state. There is considerable doubt among legal experts as to what rules would apply (e.g., "What's Next In Bridgeport's Bankruptcy," Wall Street Journal, 6/14).

Broader Implications: Shortly after the bankruptcy filing, Bridgeport's mayor joined the mayor of Minneapolis as he presented concerns over central cities to a Congressional committee. They raised the broad concerns over central city finance often addressed in **Reports** and by a wide variety of state actions.

Those concerns are particularly salient in the Northeast at the moment because of the convergence of several factors. First, recession has hit the Northeast hardest with adverse effects on city residents, city tax bases, state aid, and state ability to provide emergency assistance. Second, Northeastern cities and towns are small independent entities with no overlapping county governments. The cities and towns are responsible for social and health service costs which counties handle in other states. The independence and small size of these New England jurisdictions mean that more affluent taxpayers can, and do, leave behind the problems of communities like Bridgeport, Hartford, and New Haven and their counterparts in other New England states.

State Action: There are state mechanisms specifically designed to deal with distress in individual local communities, including the Connecticut board established to deal with Bridgeport. This year, for example, Massachusetts has provided emergency aid to Chelsea and Rhode Island is taking over the school system in Central Falls. Actions like these have a general statutory base in Pennsylvania, see "Locals In Distress: What Can States Do?" by Ron Snell and Scott Mackey in NCSL's Fiscal Letter (May/June).

MISCELLANY

Associations Of State And Local Officials: Many of the major associations of state and local officials -- like the National Governors' Association, the National Conference of State Legislatures, the National League of Cities, the National Association of Counties, and the U.S. Conference of Mayors -- have a strong federal orientation. With the exception of most of NCSL's operation which is in Denver, they are based in Washington, DC. Substantial parts of their budgets come from federal grants. Large parts of their meetings and policy positions are devoted to federal, not state and local, policy decisions. Much of their staff activity is associated with reporting on federal developments and lobbying for members' preferences for federal policy.

In Governing (June), Jonathan Walters concludes the groups are having to confront the question: "Should Washington remain the center of their universe when the federal government is all but ordering them to solve their own problems with their own money?" He sees the debate as more intense for organizations of local officials than organizations of state officials. Several people prominent in local government affairs are quoted as suggesting the local organizations should focus more on states.

Ellen Perlman takes a broader swipe in City & State (6/3):

> Despite lobbying by the associations, state and local jurisdictions have taken a pounding from the federal government in the form of decreases in grants and increases in both the number and cost of mandates.

> Are the associations providing what members want -- and need? Are members getting their money's worth from those who represent them?

But she concludes that membership in the associations is "vital." Much of her extensive discussion of association work concerns the two organizations representing cities and how they do, and don't, work together.

Governors' Opinions: An otherwise standard description of state and local fiscal problems in Newsweek (7/1) has a poll of 46 of the nation's governors "or aides they designated." There were some predictable answers, such as suggesting fewer federal mandates, and some less predictable ones. Asked "What are the most serious unmet needs in your state because of budget problems?" 57% picked health care, followed by social services (43%), higher education (41%), and public works (42%). Lower concern over unmet needs was expressed for secondary education (26%), prisons (24%), housing (20%), and law enforcement (13%). Asked to select governors (other than themselves) most effective in their positions, responders picked governors who have been in office at least a few years and have been active in the National Governors' Association. In order, choices were Clinton (D-AR), Romer (D-CO), Gardner (D-WA), Campbell (R-SC), and Ashcroft (R-MO).

Legislative Demographics: The changing composition of the North Carolina legislature shown in Table 8 shows demographic aspects illustrating national trends and political changes characterizing the formerly solidly Democratic southern legislatures.

Table 8: Percent Of North Carolina Legislators With Selected Characteristics

Characteristic	1971	1991
Democrats	82%	69%
Republicans	18	31
Males	98	85
Females	2	15
Whites	98	87
Blacks	2	13
Lawyers	40	21
Percent Members New To Legislature -- Senate	36	16
Percent Members New To Legislature -- House	36	18
Average Age of House Member	49	57

The increasing percentage of women in legislatures is a nationwide phenomenon documented in the April-June Journal Of State Government, which is totally devoted to women in state politics. Women are under 10% of legislators (1991 data) only in Louisiana (lowest at 2.8%), Kentucky, Alabama, Arkansas, Mississippi, Oklahoma, and Pennsylvania. Over 30% of legislators are women in Arizona (highest at 33.3%), Maine, New Hampshire, Vermont, Washington, and Colorado.

Legislative Staff Cutbacks: In mid-June, the California Supreme Court provided a reprieve to legislative staff members scheduled to be laid off as part of implementation of Proposition 140. The decision is a temporary one, pending final decision by the court on the constitutionality of the proposition. Besides mandating a reduction in legislative staff, it limits the terms of legislators.

Tax Expenditures: About a dozen states prepare periodic reports on "tax expenditures" -- revenue forgone because of exemptions to current state taxes. One of the better examples is the 246-page California report. There are complex definitional issues involved in measuring the revenue loss from tax exemptions. Not the least of these is whether a "tax expenditure" should be viewed as this loss or as the amount of budgeted spending required to produce the same effects.

The study concludes that in FY 1992 tax expenditures cost California state and local governments $24.5 billion, of which $19.9 billion was state loss. The state loss compares to general fund spending of about $43 billion. The loss is greatest for the personal income tax, 67% of the amount collected. Losses were smaller for the corporate income tax (32%), sales tax (25%), and other taxes (6%).

Tax expenditure reports have become a veritable hunting ground for elected officials seeking ways to raise money without increasing tax rates. The governor's proposal in California seeks to end the sales tax exemptions for bottled water, candy, equipment rentals, fuel for boats and planes, magazines, newspapers, and snack foods. Legislators have proposed closing other exemptions.

In most states, conformity with the federal income tax code is valued highly enough to preclude serious consideration of state decisions altering federal income definitions. There are a few exceptions, such as exclusion of Social Security income in many states and differing treatment of capital gains in a few. But these are rare. In California, proposals to alter the income tax base are common. Examples from this year: (1) eliminating deductibility of mortgage interest for second homes, (2) ending the step-up of basis of capital assets transferred at death, (3) limiting the deductibility of entertainment expenses, and (4) limiting carrying forward losses on corporate returns.

Tax Preferences: A recent California poll (Sacramento Bee, 6/11) confirms previous polls on the public's tax preferences. Increasing the sales tax rate by 1.25% and a 2% tax on all utility bills drew more opposition than support. More narrow proposals, with less revenue raising potential, did better. There was slightly more support than opposition for two proposals to broaden the sales tax base, one to cover amusements like movies and sporting events and the other to cover candy, newspapers, and magazines. Raising the top bracket individual income and corporate income tax rate from 9.3% to 10% got 47% support and 26% opposition. Raising the individual rate from 9.3% to 11% for individuals with income over $100,000 ($200,000 for couples) got 70% support and only 17% disapproval.

TECHNICAL NOTES

Education: The math scores are from the U.S. Department of Education, The State Of Mathematics Achievement, reflecting work done under contract by the Educational Testing Service. The authors don't like using rankings for their data, as **Reports** did. The report will be forming the starting point for further state-by-state comparisons, see "Panel Chooses Achievement Measures," Governors' Weekly Bulletin (6/7) for details. The National Governors' Association reports progress of its goals project in the Bulletin and other publications such as State Actions To Restructure Schools and State Strategies For Achieving The National Education Goals. The National Education Association (1201 16th St., N.W., Washington, DC 20036) data appeared in Estimates Of School Statistics: 1990-91. For overviews of school finance see Advisory Commission on Intergovernmental Relations (Washington, DC 20575), The Structure Of State Aid To Elementary And Secondary Education or the less elaborate, more readable NEA summary, What Everyone Should Know About Financing Our Schools.

For a popularized summary of research on the outcomes of choice programs, see New York Times (6/12). There are many studies of choice, but generally these are assessments of arguments for and against rather than assessments of results. See, for example, Abigail Thernstrom, School Choice In Massachusetts (Pioneer Institute, 1105 Commonwealth Ave., Boston, MA 02215, 1991) and William Clune and John Witte, Choice And Control In American Education (Falmer Press, 1990).

Legislative Demographics: The profiles are from a 246-page assessment, Article II: A Guide To The 1991-92 N. C. Legislature (N.C. Center for Public Policy Research, P.O. Box 430, 5 W. Hargett St., Raleigh, NC 27602).

Tax Expenditures: The California report, Analysis Of The 1991-1992 Tax Expenditure Budget, is produced by the Legislative Analyst (925 L St., Sacramento, CA 95814).

Lotteries: The lottery sales compilation appeared as an insert in the May 15 issue of Gambling and Wagering Business.

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VOLUME 9 ISSUE 14

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For most states, paying for existing Medicaid services was the emphasis this year, with "bootstrap financing" the key. But some states, like Iowa and New Jersey, addressed other health finance issues.

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Public higher education officials have assessed how the budget pie was divided this year and found they got a smaller piece.

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Rising welfare caseloads have been putting pressures on state budgets. State responses have varied, with new emphasis on general assistance.

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State finances have been in the news, but primarily because of decisions not made on time in a few states rather than the decisions that were made.

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The Census Bureau decisions on population counts will affect many state policies as well as Congressional representation and federal aid.

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July 1991 (Second of Two July Issues)

RABBITS OUT OF THE HAT

Introduction: The carnage from the 1991 legislative sessions has been substantial from the standpoint of taxpayers, affected by $16-20 billion of new state taxes, and those interested in state spending (see Issue 13). But the impacts aren't as great as they could have been. Why not? Faced with the difficult choice between cutting spending and raising taxes, state officials looked for a way out. To some extent in some states, they found it.

Patterns Of The Northeast And California: The worst fiscal problems were concentrated in the Northeast and California. Many of these states found it necessary to undertake major tax hikes and cuts in spending patterns. Per capita state tax increases in the $100-250 range roughly approximate what happened (or is likely to happen) in California, Connecticut, Maine, Pennsylvania, Rhode Island, and Vermont. In addition, these states have selected half or more of a standard list of austerity measures -- reducing personnel, shifting some costs of employee benefits to employees, freezing local aid, raising university tuition well above the inflation rate, denying salary increases, rejecting welfare payment increases, cutting reimbursements for health care and social service providers, and avoiding new programs.

Budget Magic: Four states seem to have fared better than others similarly situated. The four share demographic characteristics with the others and have experienced the recession to at least the same degree. They have experienced the same shortfalls in revenue. They are subject, in varying degrees, to the same pressures to increase spending as the others, excepting school finance equalization cases. They took some of the same budgetary steps. But in broad overview, they appear to have done better. That is, they have neither increased taxes as much as comparably situated states nor have they been forced into the same magnitude of expenditure cuts. The states are Massachusetts, New Hampshire, New Jersey, and New York.

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New Hampshire has felt the recession about as badly as any other state. Nearly everyone believed the state's avoidance of personal income and general sales taxes would be severely tested. That consensus included the governor, who pledged to veto either measure. The governor and sympathetic legislators worked on alternatives which would tax businesses differently to reach returns of professional businesses (which have no taxable profits). But as the legislature concluded work in late June, there was no new business tax, no personal income tax, and no general sales tax. There were other tax increases -- telephone service, inheritance, the tax on the state's only nuclear plant -- but no broad-based tax was enacted.

New Jersey enacted its massive tax hike in 1990, but committed all the new money for school aid, property tax relief, and aid to hard pressed urban governments. Recession affected the rest of state finances as though there had been no tax increase. All participants agreed that another tax hike was out of the question. The new budget has no tax increase.

New York clearly faced problems. In December, before the magnitude of economic downturn was known, the governor was talking about 10,000 layoffs and critics were arguing the state's use of "one-shot" devices to balance the budget had worked it into a serious hole. Yet New York finished the session, and subsequent renegotiations, with tax increases of under $100 per capita that won't be noticed by most residents. Layoffs are possible, but are unlikely to be massive.

New York City was on the receiving end of some of the state's cuts and has severe fiscal problems even without the cuts. There are double digit increases in city income and real property taxes as well as other tax and fee increases. Substantial layoffs are also being made, perhaps over 10,000.

Massachusetts really pulled a fiscal rabbit out of a hat -- a second Massachusetts miracle. The FY 1991 budget was out of balance by all reckoning when the new governor took office. Early this year, by some estimates, a budget of $13-14 billion for FY 1992 was out of balance by as much as $2 billion. Now the state has a budget said to be balanced in FY 1992 after finishing a balanced FY 1991. Furthermore, the sales tax on services scheduled to go into effect in the spring was repealed and a slight drop in the income tax scheduled for the end of 1991 will now take place on schedule. While other Northeastern states raised taxes substantially, Massachusetts will be one of a couple of states to lower taxes by 1991 legislative action.

How They Did It: These states put together many techniques that avoid cuts in state operations and also avoid tax increases. The pejorative terms were those used by New Jersey's largest newspaper (Star-Ledger, 6/27) in describing the House version of what became the budget -- "depends largely on blue smoke and mirrors," "a series of magic tricks worthy of Houdini," and "easy money that ... simply isn't there." A non-pejorative way to express the techniques are as deviations from relatively standard budgeting and accounting practices. Some reflect policy decisions, such as shifting more responsibility to local taxpayers for local costs and to students for university costs. Fiscal difficulties clearly made these policies more acceptable to state elected officials than they otherwise would have been. The major policies are listed below:

Costs are shifted from tax revenues to fee revenues. The most common shift was in university budgets. Tuition increases for residents were 22.5% in Massachusetts, 5.5% in New Hampshire (where fees are nearly tops in the nation), 9% in New Jersey, and 59% in New York (SUNY). Fees also went up with a 70% increase reported in Massachusetts and 8% in New Hampshire. Fees for drivers licenses, environmental permits, professional licenses, park admissions, and more were also used.

Local aid is cut. On a continuation budget concept, state aid to local governments would increase by roughly the inflation rate plus or minus changes in workload such as population for many programs and students for school programs. One notion of austerity is to increase local aid only by the amount of state revenue increase, which would be roughly zero in some of the four states. New Hampshire has little local aid to cut. New Jersey withdrew some of the school aid money that was part of the tax and education plan adopted two years ago. New York cut both unrestricted aid to general purpose governments and school aid. Massachusetts cut local aid (which includes school money) by about 15%.

Local governments often got new authority to raise money, including a sales tax increase on Long Island, an income tax increase for New York City, and (pending final approval) new freedoms from Proposition 2 1/2 restrictions on property taxes in Massachusetts. The substitution of local for state taxes doesn't go unnoticed. For example, the Boston Globe's editorial summary (7/2) of the state budget included the comment, "It would be a serious misperception of the situation to call this budget a no-tax document because the reduction of local aid will force many communities to attempt overrides of Proposition 1 1/2..."

Unspecified savings are assumed. **Reports** isn't familiar with the details of each of the four state budgets, but it would appear that some relatively heroic assumptions about savings have been made in accounts where the appropriations aren't really spending ceilings. The Massachusetts budget contemplates savings against current service estimates of nearly 20%. New York's budget assumes savings, modest in FY 1992 and larger later, from moving to managed care in Medicaid.

The Massachusetts budget emerged from the Senate with broad authority for the governor to make cuts administratively in the approved budget. The provision didn't survive in the final version, but the concept of finding cuts after budget enactment did. In Medicaid, for example, the cut is $420 million, about 15% of spending. Within a week after the beginning of the fiscal year, state Medicaid officials were saying publicly that they were unlikely to stay within the budget.

Revenues are accelerated. The best example of revenue acceleration is New Jersey, where approximately $600 million (about $75 per capita) is brought into FY 1992 by accelerated collection of the utility tax.

Assets are sold. New Jersey's budget benefits from $400 million in revenues from selling a portion of Interstate Highway to the turnpike authority. New York sold a prison to a state authority. New York City is selling housing units to the New York City Housing Authority and selling a city-held mortgage on a housing development. The Massachusetts plan has asset sales also, though the governor and legislature haven't gotten together on language or what is to be sold.

Bond funds are substituted for operating money. New York adopted a complex arrangement involving the turnpike authority. Its economic substance is to borrow the costs of aid payments to local governments for transportation. New York City planned to revive the practice of using bond funds for routine maintenance, in this case painting bridges. This specific practice was followed in the early 1970s before the city's fiscal crisis, but ended as part of the reforms to prevent recurrence of the crisis. The city comptroller vetoed revival. However, the search is probably now on for financing with comparable savings in this year's budget without the embarrassing parallel to the practices that led to the fiscal crisis.

Payments are postponed. Postponing payments takes many forms. Several states delayed payments to pension plans. Some are delaying payments to employees by furlough days or shifting payroll dates. Some payments to vendors, to those due tax refunds, and to local governments have been delayed. Debt refinancing and stretchout is apparently a part of the Massachusetts and New York City plans.

Medicaid bootstrap financing is used. Bootstrap financing didn't play a massive role in resolution of budget issues in New Jersey and New York, but it did in the other two states. A federal payment of $500 million was a key element in balancing the FY 1991 budget in Massachusetts, thereby avoiding a deficit to be carried into FY 1992. Bootstrap financing was the key unlocking the door to budget agreement in New Hampshire. It provided enough money so legislators didn't have to decide the hotly contested issue of how to raise business taxes and didn't have to consider adopting a sales or income tax. As the $118 million was included late in the session, it was dubbed the "Massachusetts loophole."

Nothing is held for contingencies. None of the four states have budgeted substantial end-FY 1992 reserve funds, rainy day funds, or balances. No covert reserves appear to be lurking in deliberate overestimates of spending, probably the reverse. In revenue estimates, however, the situation is less clear. A substantial case is being made in Massachusetts -- by a taxpayers group and an economic forecasting firm -- that revenue assumptions are too pessimistic.

Combination strategies are followed. This year's best example of a combination strategy appeared in Massachusetts. Cuts in local aid shifted part of the state's shortfall to local government. The budget legislation set about relieving the resulting pressure on local governments by, among other things, allowing communities to defer certain teacher pay from one fiscal year to the next.

The Consequences Of Budget Magic: The immediate consequences of most forms of budget magic don't appear severe, which explains their popularity. One-shot improvements to balance a budget, shifting costs to future years, and borrowing revenues from future years all improve a present situation at the expense of future finances. So does underestimating spending for Medicaid and other programs. Neither taxpayers nor those affected by spending are likely to notice until some future year. Even in that future year when adverse affects are felt, the association between then-current problems and past actions won't be obvious except to experts.

Rating agencies do notice. Standard & Poor's dumped New Jersey out of the AAA list immediately after the budget was adopted. That will have some effect in increasing interest cost, but an unknown political effect. Massachusetts has a "bottom-of-the-barrel" rating already.

The impact of higher fees, particularly higher education tuition, is difficult to assess because it depends upon future fiscal strategy. New York, for example, went for years without any tuition increase and then adopted a large one. If it follows this by several years of no change, its policy may work out the same as that of a state that makes small adjustments every year. If large increases become a policy, then it, and other states like Massachusetts, could shift to a position like that of Vermont, where state institutions compete with private ones with little subsidy from taxpayers. Without a major scholarship program, the result is likely to be less attendance by middle class youth.

The impact of local aid cuts will probably bring the most excitement to the politics of Massachusetts, New Hampshire, and New York. Having a smaller portion of local costs paid by state aid accentuates the disparities in tax base among small local communities. Indeed, how much equalization to maintain was one of the most difficult issues for the Massachusetts legislature. One choice was cutting all aid proportionately, which affected the high-aid distressed communities most per capita. The alternative was equal per capita cuts, which concentrated the highest percentage cuts on more affluent communities.

Local aid cuts will, no doubt, result in both lower spending and higher local taxes than would otherwise be the case, with no way to determine how much of which has occurred. The effects will likely increase pressures for more state aid from local officials, those who don't like property taxes, and employees like teachers. There is already a substantial movement in Massachusetts for a one-cent higher sales tax for education.

HEALTH CARE FINANCING

Introduction: There is no evidence of any slackening in the cost pressures on state Medicaid programs. Instead, an increasingly key means of financing state contributions is under attack and pressures to raise costs continue unabated.

Bootstrap Financing: State match being put up by provider contributions and dedicated taxes on providers is mounting rapidly to a number like $5 billion in FY 1992. Assuming the worst, this match will be disallowed by the federal government when the prohibition on disallowance runs out on January 1, 1992. This would mean the loss of over $3 billion to states during FY 1992. A few states would be in a position to pass the adverse consequences on to providers, but most wouldn't. The same $5 billion, probably grown to more like $6 billion, will be assumed in the FY 1993 budgets. The maximum state exposure to disallowance is therefore about $10 billion of federal matching funds, which will represent about 2% of general fund budgets. The exposure will not be evenly distributed among states.

These numbers may not be right. No one can know the right numbers because they depend upon decentralized decisions in 50 states. But while the national total is speculative, officials of each state will know how much they have at stake and how it compares to their total budget. ***Bootstrap financing seems destined to be the issue of the year in state-federal relations in 1992.*** Its resolution will spill over into other areas, with probably more public school money at stake in bootstrap financing for Medicaid (with indirect effects on state ability to finance schools) than in the possible changes in federal education funding.

In late June, the leaders of the National Governors' Association indicated their support of continued bootstrap financing. In a letter directed to the Congress, they commented:

> The combined impact of increased demand for public assistance, federally mandated Medicaid expansions, and runaway health care inflation are driving Medicaid costs up at a time when states are also experiencing the fiscal pain that accompanies recent downturns in the national economy.

The governors suggested it was "critical that states retain maximum flexibility to raise revenue to meet the swelling budgetary demands of state Medicaid programs."

Legislators made a similar pitch in a letter from their President and President-elect to President Bush. It objected to federal actions adversely affecting states in five areas: (1) child care regulations, (2) clean air regulations, (3) medical malpractice, (4) mandatory Social Security coverage of some state and local employees, and (5) Medicaid bootstrap financing. It indicated that federal regulations to restrict the practice were apparently being drafted that "would severely restrict states' revenue-raising authority and limit their ability to meet their obligations under Medicaid and to provide health care to their poor and elderly populations."

State Health Notes predicted in its June issue that "odds now are on" the Congressional option of letting the moratorium that protects bootstrap financing lapse. It suggested that states will be shifting from the more risky donations strategy to the less risky provider-specific tax strategy.

In mid-July, the Secretary of the Department of Health and Human Services and the OMB Director issued a press release on Medicaid costs. They noted the rapid increase in state and federal costs and predicted continuing rapid growth unless costs are constrained. It characterized bootstrap financing as "sleight of hand funding schemes" and promised "reforms" in dealing with them that would save $15 billion a year in federal Medicaid spending by the mid-1990s.

Reimbursement Rates: Complaints over state Medicaid reimbursement rates were recently offered by the American Hospital Association and the Physician Payment Review Commission. The Commission found Medicaid rates well below those of Medicare, with considerable diversity among states (see Issue 8).

The Hospital Association concluded that states were paying 78% on the dollar of "cost." It said there was substantial variation in hospital rates as well, ranging from 106% of cost in New Jersey to 53% in Illinois. Critics promptly pointed out that for AHA "cost" is what is seen by the hospital while for states the requirement is reimbursement of cost of an efficiently and economically operated facility. The difference is best seen when a hospital is 50% occupied and a state views efficient operation as 100%. The hospital will perceive a much higher cost per patient than those setting reimbursements.

New Jersey Legislation: New Jersey has now enacted health care legislation which Governor Florio called "a breakthrough for containing health care costs in New Jersey" that "will be a guide for other states to follow instead of waiting for a long-overdue national solution to come from Washington." However, the legislation's key money provision is the old uncompensated care trust fund with a new name. It is funded by a tax of up to 19.7% of hospital gross receipts. The governor and legislative leaders have indicated they don't expect to support renewal beyond the scheduled June 1992 expiration date. The fund is so controversial that it lapsed in January and the legislation to renew it passed by slim majorities.

Among other things, the legislation seeks to shift costs from uncompensated care to Medicaid by expanding Medicaid eligibility and taking steps to ensure that hospital patients who qualify for Medicaid are signed up for the program. A tax of 0.53% of hospital gross receipts will be used for cost containment efforts including expanding community health centers. The concept of a universal plan financed by a payroll tax ($100-200 a worker-year) and employer coverage or a penalty (about $1,000 a worker-year) for not providing it are still under active consideration for 1992 decision, after the 1991 elections.

In his signing ceremony, Governor Florio expressed concerns about financing medical care that parallel concerns being expressed by state officials throughout the nation:

> The high cost of health care is squeezing the middle class of our country dry. It used to be taken for granted that being an American meant receiving the best medical care in the world. Now we're faced with a cruel irony. The care is out there and we've managed to find cures for diseases that used to be death sentences. But too often we've replaced the heartbreak of illness with the heartbreak of bankruptcy.

Medicaid As An Incentive To Be On Welfare: For persons whose jobs provide no medical coverage, or don't cover their medical problem, Medicaid can provide a strong inducement to quit the job. In states that cover the medically needy, a low paying job can be maintained while on Medicaid. In the other states, eligibility for cash assistance is required to be on Medicaid. This is usually inconsistent with holding a full-time job.

No one knows how many people move from work to welfare because of the inducement of Medicaid coverage to deal with expensive health problems. A national audience saw an example involving a traditional (mother, father, child) family on NBC's morning TODAY program (7/9). The 5-year old child has an expensive medical problem not covered by the parent's health insurance. The family was told that government would pay for the child's care if either: (1) the couple abandoned the child who would then become a public ward or (2) the parent quit work and the family went on welfare, and thus Medicaid. The family took the second course, leading to a child successfully treated and a happy family, though unhappy with its poverty, as chronicled for morning viewers.

Although **Reports** is not aware of studies indicating the extent of the impact, it appears to be widely believed that participation in one income-tested program promotes caseload growth in the others. That is, anything increasing participation in Food Stamps, Medicaid, public housing, cash welfare assistance, or smaller programs encourages participation in the others. One theory is that the first participation breaks a psychological barrier to taking government assistance. Another is that the caseworkers for one program point out eligibility and assist with paperwork for the others. For example, USA Today (7/9), in discussing reasons for welfare caseload growth, listed expanded Medicaid eligibility as a reason. It notes, "When Congress extended health coverage to more poor pregnant women and children, many learned, for the first time, that they also were eligible for AFDC, food stamps and other government aid."

State Health Insurance Initiatives: Legislation passed in Iowa this year is indicative of the approaches some states have been taking to increase health insurance coverage with relatively low (and hidden) costs. While the details are complex, the principle is simple. To solve the problem of high rates and/or sharp premium increases for some small businesses, the state is requiring the sharing of the costs and risks. Particularly high premiums develop when a small group has high loss experience because of the high medical costs of one or two employees. Insurers are prohibited from increasing rates by more than 15% just because of this experience and can't cancel the policy because of the past losses. There is no control over cost increases for other reasons and no new limitation on company profits. Therefore, the plan simply spreads the risks. So does another feature designed to deal with small businesses that can't get coverage at all -- an assigned risk pool comparable to that used for auto insurance.

Second, Iowa recognized that some of its own mandates of services to be covered drive up the cost, and drive down the acceptance, of health insurance. So bare bones policies can be offered to employers who haven't provided health coverage in the past 12 months. The state forgoes its 2% premium tax on such policies.

Third, there is a complex plan (with regulations yet to specify details) that is designed indirectly to subsidize coverage for low income workers. For employers who pay 75% of their health care cost, there will be a $25-per-month discount for each low income worker. The insurer provides this discount but the insurer will recoup the discount from the state by an equal reduction in insurance premium tax payments. Recognizing that this could prove popular and expensive, there is a legislative cap of $1.5 million on this deduction.

HIGHER EDUCATION TAKES A HIT

Budget Cuts And Small Increases: In covering state budget actions this year, **Reports** has been suggesting that higher education budgets have been taking a beating in states trying to deal with fiscal problems while avoiding or minimizing tax increases. The early returns -- in the form of a survey of members by the American Association of State Colleges and Universities -- are now in. It suggests that higher education appropriations dropped in about half the states, as shown in Table 1.

Table 1: Percent Change In FY 1992 University Appropriations

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Indiana	21.0%	18	Georgia	3.0%	35	Virginia	-5.0%
2	North Dakota	11.8	19	S. Carolina**	2.5	36	New Hampshire	-5.5
3	Montana	10.1	20	Florida	2.2	37	Minnesota	-6.0
4	Arkansas	9.6	21	Arizona	2.0	38	Vermont	-7.0
5	Utah	8.2	22	Colorado	2.0	39	California	-7.9
6	Idaho	7.1	23	Iowa	2.0	40	Connecticut	-8.0
7	Oklahoma	7.0	24	New Mexico	2.0	41	New Jersey	-8.0
8	Hawaii	6.0	25	Wisconsin	-1.0	42	Rhode Island	-8.0
9	Alabama	5.0	26	Washington	-1.6	43	Massachusetts	-10.0
10	Kentucky	5.0	27	Maryland	-2.0	44	Tennessee	-10.0
11	Illinois*	4.5	28	Alaska	-2.5	45	Oregon	-11.0
12	Maine*	4.5	29	Mississippi	-2.5	46	Delaware	n.a.
13	Missouri*	4.5	30	North Carolina	-3.0	47	Louisiana	n.a.
14	Pennsylvania*	4.5	31	Kansas	-3.5	48	Nevada	n.a
15	West Virginia*	4.5	32	Nebraska	-4.0	49	Texas	n.a
16	Michigan	4.0	33	Ohio	-4.0	50	Wyoming	n.a
17	South Dakota	3.1	34	New York	-5.0			

* Precise percentage imputed by **Reports**, see Technical Notes.

The median increase, according to the survey, will be about 2%, well below inflation. Only eight states exceeded 5%. Those states involved special situations, such as states that felt recession less than other states or states increasing taxes for education. Nearly half the states, with more than half the nation's population, cut higher education appropriations.

Tuition Hikes: The strategy of cutting higher education appropriations but making up some of the difference by higher tuition was common. This accounts for many of the double digit increases shown in Table 2.

Table 2: Percentage Change In In-State Tuition, FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New York	59%	18	Ohio	8%	32	Kansas	5%
2	Connecticut	29	19	Alabama	8	32	Oregon	5
3	Massachusetts	22	20	Michigan	8	32	South Dakota	5
3	Rhode Island	22	21	Oklahoma	7	32	Tennessee	5
5	California	20	22	Indiana	7	32	West Virginia	5
6	Florida	15	22	Minnesota	7	32	Nebraska	5
6	North Carolina	15	22	South Carolina	7	41	Maryland	4
8	Mississippi	14	22	Virginia	7	41	Georgia	4
9	Missouri	12	26	Arkansas	6	43	North Dakota	3
10	Kentucky	10	26	Idaho	6	43	Wisconsin	3
11	Maine	10	26	Utah	6	43	Arizona	3
11	Pennsylvania	10	29	Montana	6	46	Louisiana	0
13	Colorado	9	30	New Hampshire	6	47	Delaware	n.a
13	Iowa	9	31	Washington	5	48	Nevada	n.a
13	New Jersey	9	32	Alaska	5	49	Texas	n.a
13	New Mexico	9	32	Hawaii	5	50	Wyoming	n.a
13	Vermont	9	32	Illinois	5			

Tuition In Texas: The Texas legislature has deferred its consideration of the budget to wait for a comprehensive report on saving money from the state comptroller. That report has now been issued. It suggests substantial changes in the support of the state's well-funded higher education system. Tuition would double for state residents, to $40 per hour, with some of the additional income resulting in a cut of state support. Universities would lose the practice of keeping out-of-state tuition to supplement other funds. The state would, in effect, take credit for university interest earnings and certain health-related revenues. Overall, the state's share of University of Texas costs would drop from 32% to 28%, well below the 45% of 1984.

Implications: For most states, this year's tuition policy adjustment is a slight one that might or might not be continued in more prosperous times. The median state raised tuition 7%, more than inflation, while raising state appropriations 2%, less than inflation. Thirty of the 46 states reporting exceeded a 5.0% tuition increase. If continued for a number of years, the cumulative nationwide effect would be similar to the dramatic one year changes in California, Connecticut, Massachusetts, New York, and Rhode Island.

The perspective of the public institutions on these events is suggested by Richard Novak, who directed the study:

> With well over 50% of institutional budgets comprised of state appropriations, the high degree of sensitivity of public higher education funding to state economic and state budgetary conditions is well known. ... Budget cuts lead to tuition increases, although these increases in no way make up for dollar amounts lost to budget cuts. The tuition increases, often times exceeding consumer price indices and personal disposable incomes in a number of states, are leading to an increased "privatization" of public higher education. States that have prided themselves on low tuition, access and affordability are being forced to put higher and higher percentages of the cost of education on the shoulders of students and their parents.
>
> Something must be done to stabilize public higher education funding from year to year so sharp and sometimes unexpected decreases will not have the disruptive effect they are now having. Until then, we can only hope that state budgets will recover, and subsequently, the funding base for public higher education.

The concept of increasing privatization of public institutions was reflected in a recent statement by university presidents in Virginia. They suggest that, without additional funding, the state may have no choice but to alter the status of some of its well known universities such as the University of Virginia and the College of William and Mary. They would be freed of state controls over tuition and management (e.g., purchasing and personnel) and would attempt to make their way in the marketplace.

DEALING WITH WELFARE

Looking At Welfare: Welfare spending was one of the most stable elements of state costs throughout the 1980s. Caseloads remained relatively stable while state officials opted to increase payments per case less than inflation. This made failures to reform welfare fiscally tolerable, even if socially unacceptable to many observers.

Welfare Reform: Putting welfare recipients to work is a continuing subject of state and federal policy concern. For both cost reasons and because of interest in the recipients' economic opportunity and the images presented for children, encouraging shifts from welfare to work has been of long standing interest. These efforts, often adopted with great fanfare such as that accompanying the national "welfare reform" effort, appear to have had little impact. This has led to efforts to look "beyond welfare reform" (Vol. 8, Issue 11), also with little apparent impact.

Payment Levels: Even in the good times of the late 1980s, states typically didn't increase AFDC payment levels to match inflation. Although the results are not yet compiled, it is unlikely that there were many increases in payment levels in the larger states this year. California broke the historical pattern of indexing its payments for inflation and reduced the cash assistance level by about 5%.

Recent Case Load Growth: Recently there has been a significant increase in the caseloads in the AFDC program, as indicated by Table 3.

Table 3: Percent Change In AFDC Caseloads, July 1989 Through April 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New Hampshire	71.7%	18	Tennessee	25.6%	35	Nebraska	11.3%
2	Arizona	41.1	19	Wyoming	24.0	36	New York	11.1
3	North Carolina	38.6	20	California	22.8	37	Michigan	11.0
4	Kentucky	37.4	21	Idaho	22.4	38	Pennsylvania	10.2
5	Florida	37.1	22	Indiana	21.4	39	Arkansas	10.0
6	Connecticut	36.9	23	Oklahoma	19.9	40	North Dakota	9.3
7	Vermont	35.7	24	Colorado	19.3	41	Kansas	9.3
8	Alaska	35.6	25	Massachusetts	18.9	42	West Virginia	8.3
9	Nevada	35.1	26	Maryland	18.7	43	Ohio	8.1
10	New Mexico	34.3	27	New Jersey	18.7	44	Hawaii	7.9
11	Texas	31.7	28	Montana	17.8	45	South Dakota	7.6
12	Georgia	29.6	29	Virginia	17.0	46	Alabama	7.6
13	Rhode Island	28.9	30	Washington	15.4	47	Iowa	6.8
14	Oregon	28.8	31	Missouri	14.5	48	Wisconsin	2.8
15	Maine	27.8	32	Minnesota	13.8	49	Louisiana	2.5
16	Delaware	27.4	33	Illinois	12.6	50	Mississippi	2.0
17	South Carolina	27.0	34	Utah	12.2			

The median state increase over the 21 month period covered by Table 3 is about 18%, suggesting an increase of nearly 1% a month. The increased caseload automatically converts into increased state costs for cash assistance. It also increases the state bill for Medicaid, as cash assistance eligibility automatically triggers Medicaid eligibility. In addition, it has more subtle cost effects for states in social service programs and even in the amounts due school districts under some state school aid programs. These costs are a major element of fiscal strain in some states that have enjoyed relative economic prosperity, such as Florida and Texas.

Causes Of The Increases: The easy explanation for the increases is recession. In a recession people have a harder time finding jobs and some lose jobs. For lack of a better alternative, the argument goes, they go on welfare. This explanation is comfortable for those who worry about state finances. It allows the cost increases to be blamed on uncontrollable national economic circumstances. It promises relief from the spending pressures at the same time economic recovery provides relief in state revenues.

Recession Not The Only Culprit: Looking at individual state increases in Table 3 quickly leads to the conclusion that economic downturn does a poor job of explaining welfare caseload increases. The Index of State Economic Momentum (Issue 12) provides a measure of relative state prosperity that can be compared with the relative welfare caseload growth. States with the worst economic momentum don't have the largest caseload growth. Some states that are leading the nation in economic performance are leading the nation in caseload growth.

Of the 10 states with the most rapid caseload growth, only three trailed the national average in economic momentum. In the three -- Connecticut, New Hampshire, and Vermont -- a case can be made that the caseload is recession-related. But Nevada was first in the nation in economic growth, yet in the top ten in caseload growth. Arizona and Alaska also showed strong economic growth, but large caseload growth. The ten states with the slowest caseload growth included five that trailed the nation in economic performance: Mississippi, Iowa, Alabama, Ohio, and West Virginia. If recession caused the welfare participation increase, these states would be expected to have higher-than-average caseload growth accompanying their lower-than-average economic performance.

Another major factor appears to be at work. Much of the caseload growth appears to be concentrated in states that have had historically low benefit and eligibility levels. In those states, the federal mandates to cover intact (two-parent) families and perhaps the mandated Medicaid coverages have had an impact. This would explain extraordinary caseload growth in states like Nevada, Arizona, Texas, South Carolina, and Florida.

General Assistance: "General assistance" has been under attack this year in several states. More attempts to cut back the program are likely if these efforts appear to succeed.

"General assistance" is a national term used to group disparate programs that provide cash welfare assistance to those not covered by federally funded SSI and AFDC programs. Needy persons over age 65, blind, or disabled receive Supplemental Security Income (SSI). That program is paid for 100% by the federal government, though some states choose to supplement the benefits. Persons under 19 and the adults in their household are covered by Aid to Families with Dependent Children (AFDC). Non-elderly adults without children get varying amounts of aid under varying conditions from local programs supported by states or, in some states, state programs. These programs, formerly called "poor relief," have names like general relief (Massachusetts) and general assistance (many states).

The plan initially proposed by Governor Weld dealt with 40,000 people on general relief in Massachusetts. They get $338 a month (plus Food Stamps and Medicaid). The governor proposed eliminating the $213 million program and substituting one of "emergency aid for the elderly and disabled." He suggested the current program is dominated by white male recipients, a majority younger than 40 with little work history, "substance abusers, ex-convicts ...."

Advocacy groups argued that cutting out assistance would increase human misery as well as state costs because recipients would fall into more expensive categories such as homeless, prisoners, and hospital patients. Critics of general relief pointed to evidence of fraud in the program. The head of the Massachusetts Taxpayers Foundation summarized the state of knowledge by agreeing there would be some cost spillover into other programs, but he didn't know how much.

The Bay State legislature rejected the overall reforms proposed by the governor, but did restrict eligibility somewhat. However, debates over the program aren't over. As viewed by executive branch officials, the legislature offered a program costing about $180 million while appropriating $116 million.

STATE FINANCES

Ringing In The New Fiscal Year: The new fiscal year began for 46 states on July first, accompanied by more national media coverage than has been seen in years. The emphasis was on the states without adopted budgets, particularly those where there was a hiatus in appropriation authority.

States With No Budgets: State Budget & Tax News counted nine states without enacted budgets at the July 1 beginning of the year: California, Connecticut, Illinois, Louisiana, Maine, Massachusetts, North Carolina, Ohio, and Pennsylvania. In addition, states with late-beginning fiscal years -- Alabama (Oct.), Michigan (Oct.), and Texas (Sept.) -- didn't have FY 1992 budgets and New York (April) was still revising its previously enacted budget.

There were significant lapses of appropriations in Connecticut and Maine. In each case, the governor (R in Maine, I in Connecticut) and the legislature (D-led in both) were in disagreement over major issues. The disagreement extended to whether to use a continuing resolution. Workers lost at least one day and facilities, like Connecticut parks, were closed in each state. State elected officials flirted with similar situations in other states, particularly Illinois and Pennsylvania. Such closings remain a possibility until final budgets are approved in each of the states.

Public Policy And Shutdowns: The short-term shutdowns of state agencies are likely to prove to have been counterproductive in state management. Whether they were productive in producing agreements more quickly than would otherwise be the case or forcing certain conclusions to be included in those agreements isn't subject to generalization.

Employees in short-term shutdowns are typically paid for their lost time, though whether they must be could be argued. In practice, federal and state officials (at least in cases known to **Reports**) decide pay is appropriate for one or more reasons. First, the forced layoff violates collective bargaining agreements. Second, the layoffs on short notice violate civil service laws. Third, the compensation is part of the overall budget agreement. Fourth, the compensation is viewed as appropriate for non-legal reasons such as fairness, compassion, or ensuring good employee relations.

There are no gains for the states in avoided costs for most programs -- welfare checks are unaffected, vendors are ultimately paid what they are owed, etc. There are some losses for the states if revenue-generating activities are discontinued, with tax departments the best, but not the only, example.

Reports knows of no detailed study of this subject at the state level. The General Accounting Office has done one of the parallel federal shutdown of October 1990. The President vetoed a continuing resolution, leaving the federal government without appropriations over the Columbus Day weekend. GAO found the result was "financially counterproductive" as well as disruptive.

The problem of periods without budgets appears considerably worse at the federal level than for states. GAO counts nine "appropriations gaps" in the last ten federal fiscal years, though some of these involve only certain agencies. On average, an educated guess is that there are 3-7 of these in the states each year -- most representing periods of less than 24 hours. The most common gap is the little noticed one between midnight and the wee hours of the following morning as legislatures complete their work under deadline pressures. GAO finds four instances in ten years where appropriations gaps led to some disruption in federal activity. In states, the average is probably 2-4 a year.

GAO recommends permanent legislation that, in effect, would provide continuing appropriation authority when Congress fails to act on budgets in timely fashion. Members of Congress as well as state officials may well resist this idea because it would make it easier to postpone final actions on budgets. There are arguments for facing the issues and timely action at both levels of government. In addition, at the state but not the federal level, postponing action generally means prolonging legislative sessions beyond their scheduled termination.

Public Perceptions Of State Finances: The media coverage often focused on the theme of states being in fiscal difficulties. This was, of course, true. However, the closings drew attention to problems of a few states. Other states did not receive the same attention. Their budget balancing measures -- including the rather severe adjustments made in spending in some states (e.g., Rhode Island) or taxes (e.g., Vermont) -- didn't draw the same attention because their legislatures acted on a timely basis.

Assessing The Outcome: The National Conference of State Legislatures will be releasing its fiscal survey in early August, to be followed by the National Governors Association/National Association of State Budget Officers Fiscal Survey about a month later. Considerably more uncertainty will be associated with the results than in the last few years. First, some key states have left decisions to be made from July through September. This includes the states from the 12 listed above that have late-starting fiscal years by law or by delay past July 1. It also includes states with legislatures coming back to reconsider major decisions such as Tennessee and probably Florida.

There is a significant possibility that expenditures in the enacted FY 1992 budgets will substantially understate what will be spent before the fiscal year is over. The budget submissions of the governors, as reported in the Fiscal Survey, were well below spending growth of past years and current service spending. This may be reflected in appropriations as well, but not necessarily in final spending.

COUNTING THE POPULATION

Counting The Population: The Census Bureau is continuing its consideration of revising the 1990 population counts. The spring 1990 enumeration missed millions of Americans, producing an undercount. Everyone agrees that this occurred, but no one knows exactly how many people were missed. By a variety of mechanisms it is possible to make an educated guess, though the guess itself is controversial.

Possible Revisions In The Census Count: The Bureau's staff released its educated guess in June. It concludes that the total U. S. population was about 254 million rather than the 248.7 million in the count. The correction is an increase of about five million or 2.1%. The correction percentages for each state are shown in Table 4.

Table 4: Increase In 1990 Population From Undercount Correction

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New Mexico	4.5%	17	Hawaii	2.4%	32	North Dakota	1.4%
2	California	3.7	17	Nevada	2.4	32	Vermont	1.4
3	Arizona	3.3	17	Washington	2.4	36	Missouri	1.3
4	Texas	3.2	21	Georgia	2.3	37	Michigan	1.2
5	Delaware	3.0	22	Arkansas	2.2	38	Iowa	1.1
6	South Carolina	2.9	22	Kentucky	2.2	38	Kansas	1.1
7	Montana	2.8	22	Mississippi	2.2	40	Maine	1.0
8	Idaho	2.7	25	Oklahoma	2.1	40	Minnesota	1.0
8	North Carolina	2.7		**United States**	**2.1**	40	Nebraska	1.0
8	Tennessee	2.7	26	Alaska	2.0	43	Ohio	0.8
8	Wyoming	2.7	27	Oregon	1.9	44	Indiana	0.7
12	Florida	2.6	27	Utah	1.9	44	Wisconsin	0.7
12	Louisiana	2.6	29	Maryland	1.8	46	Connecticut	0.6
12	Virginia	2.6	30	New York	1.7	46	New Hampshire	0.6
12	West Virginia	2.6	31	South Dakota	1.6	46	Pennsylvania	0.6
16	Alabama	2.5	32	Illinois	1.4	49	Massachusetts	0.4
17	Colorado	2.4	32	New Jersey	1.4	50	Rhode Island	0.3

Implications For States: In mid-July, the Commerce Secretary decided to use the actual count without adjustment. This decision won't end disputes over the appropriate numbers. Litigation is expected from those interested in representation in Congress and allocations of federal aid.

The adjustments, as shown by the table, are generally adverse to the Northeast and industrial Midwest while favoring the Southwest and California. They would add a Member of Congress for Arizona and California and subtract one for Pennsylvania and Wisconsin.

Adjustments have major impacts on federal aid. First, they impact all aid that is provided on a per capita basis. More important for states, they enter the calculation of the federal cost-sharing percentage for AFDC and Medicaid. That percentage depends upon per capita income in each state relative to the nation. Other things being equal, larger population means lower per capita income and higher federal cost sharing percentages.

Adjustments Within States: The adjustments become less reliable as the size of the jurisdiction affected decreases. That is, an adjustment suggesting 1.2 million Hispanics were missed nationwide is likely to be more reliable than one suggesting that 300,000 were missed in California. A California estimate will be more reliable than 50,000 for Los Angeles, which will be more reliable than 300 missed in Compton, which will be more reliable than two missed in a particular Census track in Compton. This problem is one of the arguments against making any adjustment.

In general, adjustments within states favor the larger cities relative to the suburbs. Some of the more extreme adjustments are shown in Table 5.

Table 5: Change In 1990 Population From Undercount Correction

Jurisdiction	State	Type	Percent
Atlanta	Georgia	City	5.1%
Independence	Missouri	City	0.6
Inglewood	California	City	10.9
Livonia	Michigan	City	0.1
Lowell	Massachusetts	City	-0.4
New York	New York	City-County	3.0
Stamford	Connecticut	City	-0.1
Albany	New York	County	0.8
Beaver	Pennsylvania	County	-0.1
Los Angeles	California	County	4.6

The examples in the table suggest the difficulties that can arise in translating any Census adjustment to political subdivisions. These difficulties would affect reapportionment and distribution of state aid in some programs and states. Some state aid is on a per capita basis. A few states also use per capita figures for calculating relative fiscal need, so additional population means greater state aid.

It would be possible to reflect presumed Census undercounts in state and federal aid formulas despite the Commerce Secretary's decision on the count to use for apportionment.

MISCELLANY

Defense Impact On State Economies: There is continuing nervousness about the impact of defense budget changes on state economies. While much of the publicity is associated with base closings, many states have large stakes in defense procurement. David Whitehead (Federal Reserve Bank of Atlanta) recently attempted to assess the impact of private-sector defense cuts on state economies (Economic Review, March/April). His calculation of the percentage of employment associated with defense contracting appears in Table 6.

Table 6: Defense-Related Private Employment, Percent Of Total Employment

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	7.9%	17	Hawaii	2.7%	34	Michigan	1.1%
2	Massachusetts	7.0	18	Georgia	2.6	35	Oklahoma	1.1
3	Virginia	6.8	19	Minnesota	2.6	36	Vermont	1.1
4	Missouri	6.0	20	Ohio	2.6	37	Iowa	1.0
5	Alaska	5.7	21	Florida	2.5	38	Wisconsin	1.0
6	Maryland	5.0	22	New Mexico	2.5	39	Nevada	0.9
7	California	4.9	23	Alabama	2.4	40	North Carolina	0.9
8	Arizona	4.7	24	New Jersey	2.2	41	South Carolina	0.9
9	Mississippi	4.4	25	Rhode Island	2.2	42	Illinois	0.8
10	Colorado	4.1	26	New Hampshire	2.1	43	Nebraska	0.8
11	Utah	3.3	27	Indiana	2.0	44	Wyoming	0.8
12	Washington	3.3	28	Louisiana	2.0	45	Kentucky	0.7
13	Texas	3.2	29	Arkansas	1.9	46	Oregon	0.6
	United States	**3.0**	30	Pennsylvania	1.8	47	South Dakota	0.6
14	Kansas	2.9	31	Delaware	1.6	48	Montana	0.5
15	Maine	2.9	32	North Dakota	1.4	49	West Virginia	0.4
16	New York	2.9	33	Tennessee	1.3	50	Idaho	0.3

Whitehead assesses the ability of states to absorb defense cuts by normal employment growth. He concludes that five states -- Colorado, Connecticut, Massachusetts, Missouri, and Virginia -- will have the most problems in economic adjustment.

Economic Benefits Of Spending Money: With cuts being considered for just about everything in just about every state, this year has seen a bumper crop of studies justifying spending. Many of these have broad economic rationales, such as tying education to economic growth. One category of these studies deals with federally matched programs. They suggest benefits independent of what the program does, just from the in-state spending effects and the state and local taxes on the resulting economic activity.

An example is a study, (Alan Sager, *Shooting Ourselves In The Foot*, Boston U. School of Public Health) reported in *State Health Notes* (June). The math is shown in Table 7 for: (1) the Massachusetts Medicaid program (50% federal match) calculated by the study, (2) Medicaid in a state with 70-30% match calculated by **Reports** using the study's logic, and (3) the 70-30% situation calculated by **Reports** using values more common in economic analysis of public investments. The table addresses what impact would occur from a state decision to cut Medicaid spending (state and federal) by $500 million. The same math would be used to calculate the net cost of expanding Medicaid.

Table 7: Calculating Net Costs of A $500 Million Reduction
($ millions)

	BU Method		Reports
Category of Impact	50% Match	70% Match	70% Match
Total Program Cut	$500	$500	$500
State Savings	+250	+150	+150
Lost State Tax Revenue	-89	-125	-32
Extra State Non-Medicaid Spending	-25	-25	-5
Equals Net State Government Saving	+136	0	+113
Extra Costs Spread By Provider Charges			
Local Government	-18	-18	-18
Rest Of State Employers and Patients	-50	-50	-50
Equals Net Savings To State	+68	-68	+45
Total Job Loss	5,690	7,966	7,000

There are many controversial issues behind each of the entries in the table. But there are also some points about the economics of federally matched programs, particularly Medicaid and highways, that have been strong motivators of state policy. First, in the 70-30 match situation, the state cost is extremely low even with the more conservative calculations done by **Reports**. The added federal money is itself economic activity that will be subjected to state income and sales taxes. In many cases, including highways and Medicaid, it will supplant some state spending that would otherwise take place with 100% state or local dollars. Using the BU logic, which approximates that used by provider groups in other states and circumstances, the 70-30 program is costless for state government, and thus nothing is to be gained by cutting it.

The lower half of the table reflects the tendency of unreimbursed health care costs to be distributed to other health care buyers. Taking those effects into account makes participation in Medicaid inexpensive compared to the apparent match, such as reducing an apparent $250 million Massachusetts cost in the BU calculation to $68 million. If private benefits are taken into account, expanding the program looks even better. On the BU calculation, the $68 million in state money is buying or maintaining over 5,000 jobs.

These calculations are by no means academic. Despite the austerity environment of New Jersey budgeting this year, expanding the Medicaid program was a key element of the health care legislation passed at the end of the session. Expanding Medicaid even more was a key element of the health care task force recommendations endorsed by many labor and management leaders, but not passed. The recommendations for improving the Texas budget situation that the comptroller is offering to a special legislative session have a major element of Medicaid expansion.

Gambling: In addition to actions mentioned in Issue 13 to expand legalized gambling, South Dakota upped the betting limits for the successful Deadwood blackjack tables from $5 to $25.

Tax Amnesty: Tax amnesty plans have been less popular than when an initial round of interest and plans developed several years ago. This isn't surprising because many of the plans were conceived as one-time efforts. The logic was that increased enforcement efforts, and sometimes more stringent penalties, would begin immediately. Taxpayers would have a limited amnesty period to make good their obligations. This rationale loses credibility if repeated.

But amnesty plans have proponents. First, about a third of the states haven't conducted formal programs. Second, amnesty inherently accelerates the collection of some money that would be collected sooner or later, even though the emphasis is on collecting money that wouldn't otherwise be collected at all. This puts amnesty into the family of fiscal practices that move money to the budget year at the expense of future years. For example, an amnesty plan was part of Maine's budget balancing package last year.

There were lively debates in some states over amnesty proposals originating in the legislatures and opposed by the executive branch. The Ways and Means Committee surfaced one in Massachusetts. The revenue commissioner testified that there was little to be gained from the plan, arguing the state might jeopardize future collections by offering the second amnesty in ten years. Republican legislators in Pennsylvania made several proposals. The tax agency nixed the proposal and suggested it didn't want taxpayers to believe amnesty was under serious consideration because they might delay paying taxes to take advantage of it. There were similar discussions in Florida, Illinois, New York, and probably other states.

The definitive work on concepts of amnesty and what states have done what with what results is State Tax Amnesty Programs published last year by the Federation of Tax Administrators (444 North Capitol St. NW, Washington, DC 20001).

Tax Administration And Budget Balancing: No one keeps statistics on the relationship between tax administration and the overall state budget balancing strategies.

One pattern is to respond to fiscal problems by placing more emphasis on tax collection. This includes increasing budgets for revenue collecting agencies and associated activities, such as collection activities of attorneys general. Such plans and budget allocations are often accompanied by explicit increases in the revenue estimate used in the budget. This approach was explicitly developed in New Jersey, New Mexico, North Carolina, and probably other states.

In some other states, revenue collection functions are being subjected to government-wide policies like furloughs, hiring and travel freezes, and early retirement. The pattern has probably spread to applying decision rules, such as no expansion of programs, to the tax collecting agencies.

TECHNICAL NOTES

Rabbits Out Of A Hat: Tax increases, as defined by State Budget & Tax News, do not include renewal of levies scheduled to expire like the Illinois income tax surcharge being renewed this year or the continuing postponement of New York income tax cuts. SB&TN does count as tax cuts the rare case of a scheduled tax cut that takes place. Besides Massachusetts, there were probably a couple of other states with small tax cuts as part of economic development promotion.

Higher Education: AASCU's report is Report Of The States: 1991 Annual Budget and Fiscal Survey (Updated). The organization operates from Suite 700, One Dupont Circle, Washington, DC 20036. The states designated "*" reported that the allocation was likely to be the inflation rate while the response noted "**" indicated an increase below inflation. Non-respondents are smaller states not in AASCU and larger ones where university officials wouldn't venture a guess. Not all the guesses made in states without budgets when the guesses were made (e.g., Pennsylvania) will prove correct. California's response is the state university system (CSU not UC) and New York's is SUNY not CUNY. Rankings in Table 2 reflect fractional percentages reported by some state officials but not reprinted in the table.

State Finances: The General Accounting Office (Washington, DC) report issued in June is Government Shutdown: Permanent Funding Lapse Legislation Needed.

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Sharply rising health care costs continue to appear in private insurance rates and state Medicaid spending. Expanding Medicaid attracts interest instead of a more comprehensive national health care policy. The battle over whether states can use provider donations and taxes to supply Medicaid matching funds is heating up.

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August 1991 (First of Two August Issues)

AIR WARS, FINANCING PLANES AND AIRLINES

States And Aviation: Although the airline industry is undergoing a well publicized shake out, the industry is showing enough prosperity to be one of the few planning new facilities. State efforts to attract planned new maintenance facilities have been major issues in Colorado and Minnesota. Competing for a United Airlines maintenance base and a possible McDonnell Douglas plant has attracted attention and financial commitments in about a dozen states.

McDonnell Douglas: McDonnell Douglas has been talking with government officials about a plant to build a possible new MD-12X airliner. Eight communities are said to be in the running: St. Clair County (IL), Fort Worth, Houston, Kansas City, Mesa (AZ), Salt Lake City, Shreveport, and Tulsa. The company's major facilities are in St. Louis and Long Beach (CA). The company is using a formal procedure with candidate communities including: (1) providing its wish list, (2) soliciting proposals, and (3) assessing the proposals and making a decision.

The wish list includes utility and transportation services such as roads to the site, rail connections, fire protection, electric service, water supply, and sewage treatment. Most utilities and governments would routinely provide these for large activity centers without special charge. The company wants a 600 acre site, presumably free, graded and with interior roads, along with zoning that prevents residential construction within three miles. For personnel, it wants relocation expenses of employees, free recruitment and screening of new workers, 12-24 weeks of basic skill training of up to 8,000 employees, and additional training both initially and in future years. The company wants to spend $1.4 billion on facilities and equipment and borrow all of it "off balance sheet." The only way **Reports** knows to keep this kind of debt off the company's balance sheet is to put it on someone else's, such as the state or county. Then government or bondholders, not the company, would bear the risk if the facilities weren't used.

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Many communities are serious about the competition. The State of Kansas and some of its local governments are contributing to the $250,000 Kansas City expects to spend on the proposal. Kansas City is putting a property tax increase of 0.25% of assessed value on its ballot this year to pay for infrastructure. The group pushing passage of the measure has been advertising that the plant would be "more than a $10 billion boon to our economy." An opposition group has been formed by leaders of the Heartland Institute. They contend that the power of taxation shouldn't be used to benefit an individual company and that benefits are exaggerated.

The other seven communities will apparently propose as well, though not necessarily meeting all the terms of the wish list, particularly the term suggesting off-the-books debt. In late July, the company announced that it had enough potential plane purchasers lined up to make a production decision but lacked investment partners. This may suggest a delay in the plant location decision.

Northwest Airlines: The deal between the State of Minnesota and NWA Inc. isn't final. There are agreements yet to be worked out and approvals required from an advisory commission. But the deal is impressive in many dimensions. It involves $800-900 million for a single company. This includes industrial development bond financing of maintenance and repair facilities in Northeastern Minnesota (near Duluth). In addition, the state will forgo corporate income and sales tax revenues estimated to be $40-55 million. The significant precedent is the promise of $300 million or more in direct financing of the company by the state or its instrumentalities (e.g., the Metropolitan Airports Commission and the State Board of Investment). Also striking was the speed with which the company, the parent of Northwest Airlines which is based in Minnesota, and the legislature acted. They moved from an idea viewed in April as not likely to be seriously considered to having enacted legislation in May.

America West Airlines And More: If some states are to team up with "their" airlines as Minnesota has done, a whole new form of competition could develop. Other states would be presumably be asked by other airlines to provide similar help. In the extreme case, there would be state carriers comparable to carriers in the international market like Air France. This competition would only be restrained because states couldn't restrict landing rights (controlled by agreements under which they received federal airport financing) nor provide discriminatory taxes (prevented by the Commerce Clause of the U.S. Constitution). Is this farfetched? The Arizona Republic (6/23) tells the story:

> America West Airlines is preparing to ask Arizona and Nevada for financial aid that could total tens of millions of dollars. The amount likely will far surpass

> anything Arizona has ever considered for business assistance and touch off a major political row.
>
> The company's top executives say they must have the incentives if they are to remain competitive with airlines that are getting lucrative packages from other states.
>
> Last month, Northwest Airlines got a $740 million aid package from Minnesota. Colorado is offering United Airlines more than $300 million to build a maintenance base in Denver. Texas is considering a huge aid package for Continental Airlines, which is in Chapter 11 reorganization under the U.S. bankruptcy code.
>
> America West will ask that Arizona or Nevada form an economic partnership with the airline.

The company's president indicated that its request for aid would be based "on what it is going to take for us to continue to be competitive in light of this new kind of partnership that seems to be developing between certain companies and the states in which most of their personnel reside." Noting the action of other states, he asked whether Arizona was going to act, "or is the rest of the world going to pass it by?".

United Airlines: The United Airlines maintenance base looks like a development plum to competitors. Virginia enacted special legislation to have something to bring to the bargaining table. Oklahoma City voters passed a local tax increase for the same reason. Other states and localities are acting to keep competitive.

One was Denver where the facility provided possible major linkages with a new airport. By May, the Colorado package had evolved into special legislation designed to provide employment tax credits of up to $2,000 per employee-year for workers at the maintenance facility. Unlike most corporate tax credits, these would be fully refundable. Thus, the economics would be the same as writing the company a check every year for $2,000 times the number of jobs for each year of the agreement. At 7,000 jobs, the price to Colorado taxpayers would be $14 million a year in subsidies plus a package that included other concessions. Run over thirty years, the package would cost over $400 million. Translated into the amount the state would have to put into a trust fund if it wanted to prefund the deal, the cost (present value) was just over $200 million.

There were cost-benefit studies which showed that the deal would pay for itself in added tax revenue or, depending on the study, that it wouldn't. The studies distinguished between jobs to be filled by in-migration and jobs to be filled by those currently in Colorado. The logic was that both would bring income to the state, but in-migrants would also bring new costs for school and other public services. Editorially, the Denver Post (5/16) endorsed the proposal, noting that in another deal "it's obvious that Minnesota is offering three our four times as much as Colorado."

Significant opposition had developed by the June special legislative session called to approve the package. By the time it emerged from the legislature, the package was no longer a refundable tax credit but an up-front subsidy of about $115 million paid out over several years. The company would also get about $33 million in enterprise zone benefits by extending a nearby zone to cover the site. In addition, Denver would provide separate incentives. To avoid a constitutional prohibition against special interest legislation, the bill was set up with general language. The money would come from tax-exempt borrowing with debt service paid from the aviation fuel tax.

CLAWING AND SCRATCHING FOR DEVELOPMENT

Introduction: With the economy floundering, businesses are closing facilities, not opening new ones. This makes it hard for states and localities to compete for economic development because few prizes are being offered. Economic recovery should bring more prizes. If the few instances of current competitions are prologue, the competition will be stiff.

Competitive Strategies: In broad terms, there are two approaches to development, the particular and the general. They aren't mutually exclusive but are often discussed as though they were.

The particular strategy concentrates state resources -- from the scarce time of the governor and community leaders to subsidies and tax exemptions -- on individual targets. These aim at specific decisions of individual firms, such as a new plant or an expansion. The advantage of the strategy is that it conserves resources by not dissipating them over all existing businesses. For example, it is considerably cheaper to provide a concession to a single firm than to all firms. The main disadvantage is that the strategy is inherently unfair in the sense that it provides more of value to potential new investments than to existing ones. Another disadvantage is that it assumes negotiations with a firm considering multiple states. So it can't work for firms which don't enter such negotiations. States closely identified with this strategy are Texas and many Southeastern and Midwestern states, but nearly all states do some of it.

The airline examples in the preceding article show the particular-firm strategy at work. Past major examples include the competitions for private auto investments, like GM's Saturn plant, and government investments like the supercollider.

The advantage of the general strategy is its evenhandedness. It doesn't involve the appearance of playing favorites nor pull state officials into lengthy negotiations. The primary disadvantage is that states pursuing it may not be able to offer competitive proposals in dealing with firms looking for concessions. Because the state strategy is general policy open to all, it can be more expensive than what might be offered to a single firm. Examples of states emphasizing general business policies rather than firm-by-firm concessions range from New Hampshire to California.

Arkansas And Oregon Development: Oregon indicates the high level of economic development legislative activity in some states this year. The summary of what was done consumes 27 single-spaced pages. There is a new major program for dealing with the state's major economic dislocation (timber cutbacks) with business loans and public works projects in the affected communities. There is a new dedicated revenue source for capital construction, state operation of video lottery terminals. There is a new rural development package creating a non-profit corporation to help rural areas with strategic planning, technical assistance, and leadership training. There is also a special board to define benchmarks and monitor economic development projects. There are new job training efforts aimed at the objective of having the best trained workforce in the world by the year 2010.

New Arkansas legislation includes specific goals to be achieved by the year 2000 on such subjects as per capita income, average annual pay, average unemployment duration, and the poverty rate. Mechanisms are established to report on achievement of the goals.

Expansion Of State Development Efforts: State development activity appears to be increasing, even in recession. There is, however, no way to test this statement quantitatively. The budgets of state development agencies can be measured and compared, but the big money in economic development is outside those budgets. That big money, such as the money used to encourage the supercollider investment in Texas, is in university research budgets, the price of training commitments made by community colleges, decisions by state and local revenue bond agencies, and in tax policy decisions at the state and local level. Often, as in the many states where four-lane highways are being constructed to connect smaller communities, there is room for considerable argument over what portion of the investment should be considered driven by economic development.

Counting programs, regardless of cost, is difficult. The matrices of programs and states in the periodical Site Selection seem to grow every year. The National Association of State Development Agencies compilation of programs appears to grow each time it is issued. NADA also keeps data on state export programs which suggests how fast some state development programs are growing. From FY 1988 to FY 1990, spending on these programs grew by 58% to $92 million while the number of state foreign offices grew from 108 to 163.

Site Selection (June) provides an example of the proliferating state programs for high technology industries. These include technical assistance, university cooperation, and some programs potentially involving substantial outlays or revenue losses. They include R&D grants in 38 states, state funds for research parks in 26 states, and R&D tax credits or exemptions in 32 states.

Future State Policy: All the forces seem in place for a substantial expansion of state business incentives embedded in the tax code, particularly in the form of credits against the corporate income tax.

High rates of joblessness have elected officials looking more diligently than usual for ways state policy can contribute to economic development. These almost all involve money which will be more readily available in recovery than in recession. Investing in a single firm will remain popular, but raises concerns about evenhandedness among firms, criticisms if the firm and thus the investment fail, and violations of constitutional provisions and the policies behind them. Tax expenditures cost money, reduce the percentage of state spending financed by business, and make tax codes more complex. But they are comparatively simple to administer and inherently evenhanded.

Opposition comes from the right and left. From the right, as typified by New Hampshire policy in general and former Governor Sununu's perspective in particular, tax laws shouldn't have a lot of special preferences. Instead, a state should present an overall strong business climate and then shouldn't need special incentives. From the left, the tax expenditures are viewed as tax loopholes benefiting business and thereby forcing more of the tax burden onto individuals.

More toward the center, there are many leading figures in both parties who find tax expenditures acceptable. They are in the proposals, platforms, and legislative programs of many of the newly elected Republican governors, with Governor Weld an example. They also appear in some Democratic proposals. Passing the R&D credit in Massachusetts this year was the work of House Democrats as much as Governor Weld. In a recent speech at the American Stock Exchange, Governor Cuomo endorsed an investment credit (as well as a tax cut on capital gains from productive assets held for long periods). He was addressing Democratic perspectives on national, not New York, issues. But an investment credit can't be good policy at the federal level and a moral outrage at the state level at the same time. In New Mexico, the governor and others are backing removing research and development services from the base of the gross receipts tax.

While Democratic legislators in Massachusetts were passing their R&D credit, Republican legislators in New Hampshire were providing a credit of 15% of compensation costs for newly created jobs and an investment credit for small business. Both states would be on anyone's list of states that could least afford revenue loss.

Drawing The Line: Deciding where to draw a line to conclude that luring a large investment isn't worth the expense isn't easy. Theoretically, some sort of consensus or economic equilibrium would develop eventually based on the economics of the situation. That is, states that invested too little or too much would recognize their errors and adjust so state policies would more or less converge.

But there are other factors at stake. First, being responsible for losing a development plum has a political cost to elected officials over and above any net benefits (or net costs) from attracting the facility. Second, there are massive intangibles associated with spin-off developments. For example, officials of St. Clair County (outside East St. Louis) may not see just a large aircraft plant, but see their area becoming another Seattle. Third, losers from plant subsidies aren't often heard from. Winners are those with fixed investment in a community who benefit from more economic activity, such as newspapers and TV stations. Losers include those not helped economically who lose through increased congestion and taxes, such as retired persons.

The case for going all out was expressed most forcefully in a mixed metaphor by Kansas City's mayor in June. In discussing putting a tax measure on the ballot, he indicated that the plant was "the greatest economic development opportunity for Kansas City during this century. He continued, "If we fail to put forth a full-court press, it would be tantamount to shutting a window on our hand."

Constitutional Factors: Finding a way for Arizona to take a stake in Air West is difficult because the state constitution has a prohibition against the state lending its aid or credit to a private party. The prohibition, which appears in many state constitutions, was drafted to prevent exactly what Air West wants Arizona to do -- use taxpayer money to assist a private company in the hope it will create jobs for residents and markets for merchants.

In the early 1800s, waterway construction by private canal companies was widely viewed as the key to economic development. Many states provided subsidies and lent money. As a result of corruption, unanticipated costs and construction problems, and changing marketplaces, many of the canal companies folded. This left the states with no return on their subsidy investment and debts to cover out of tax revenues. Reacting to this fiasco, many Eastern and Midwestern states put the "aid and credit" prohibition in their constitutions. Western state constitutions were often modeled on them.

With no memory of their origin, those interested in development dismiss the provisions as anachronistic and seek their repeal, which has happened in some states. But not all. In New Mexico, for example, Governor King opposes eliminating the constitutional provision that forbids using public money to further private interests.

There are residues from the era of public-private partnerships. In mid-June, the State of Virginia completed a deal that unwinds its stake in the Richmond, Fredericksburg & Potomac Railroad, which was an investment made in 1834. The state, which turned its investment over to its pension fund decades ago, loses its minority shareholder status in the railroad. It gets valuable Northern Virginia land previously used as a rail yard. In Wyoming, which has a constitutional provision forbidding aid to railroads, the attorney general has recently ruled that the state cannot enter into subsidy contracts with Amtrak.

GOVERNING TEXAS

Special Session: When they met earlier this year, Texas legislators made extensive and expensive revisions to their school aid formula to satisfy a court order for equalization. But they decided to defer considering the budget for the fiscal year starting in September. The problem was a gap of $5-7 billion in a biennial budget of about $50 billion. Instead, they opted to schedule their budget session in July and commissioned a report from the comptroller on how to save money and one from a blue ribbon group on how to raise it. Predictably, the 1,000 page report on saving money has drawn the most initial interest. It sold out its initial printing and reprints are reportedly selling quickly, aided by marketing devices such as a special number for ordering it (800-BEAT-WASTE).

Tending The Ranch: The governor opened the session by talking about horses. She described a West Texas rodeo event in which one of the cowboys tries to settle a wild horse down by biting its ear. She said, "We are biting the ear of government -- settling it down long enough to get a saddle on it and turn it into a workhorse." Her reference was to recommendations on state reorganization in the comptroller's report. They include consolidation of smaller agencies, replacing agencies headed by boards and commissions with ones headed by appointees of the governor, and establishing new major departments of environment and transportation. Switching to cows, the governor urged that "no agency of government is a sacred cow." Back to horses, she reported that she, the lieutenant governor, and speaker had worked hard to reach agreement: "We have led the horse to water. But only you in the Legislature can make it drink."

Avoiding Major Tax Hikes: There seems to be general agreement that the savings promised by the comptroller's report and non-tax revenue measures will minimize the gap in the biennial budget. This might make it possible to avoid tax increases entirely, except for some revenue raising incident to revisions in the corporate franchise tax. Because of past litigation and widespread perceptions of unfairness, there is considerable sentiment for revising the tax whether additional revenue is needed or not. The legislative leaders and the governor have endorsed putting a lottery proposal on the November ballot. These measures along with savings and non-tax revenues recommended in the comptroller's report make serious consideration of an income tax unlikely. If tax increases are adopted, the local betting is on raising the rate, and/or expanding the base, of the sales tax.

Looking For Money: In its 1,200 pages, the comptroller's report has room for lots of fine print. Many of the savings are associated with making available for the general fund resources that otherwise would be in some other fund. Many of the higher education recommendations are of this type, triggering a long debate between the comptroller's staff and university officials on who was using the right numbers. There would also be a major consolidation of special funds, creating five "superfunds" from 301 separate funds. A scheduled sales tax exemption for machinery would be delayed, increasing revenues by nearly $400 million. Businesss would lose certain discounts for prompt payments of taxes.

The report contains many facts about state government common to states other than Texas. One which often surprises observers is the number of people paid more than the governor. In Texas, the governor makes $93,432 per year and 1,950 state employees make more. Large categories of such individuals are typically higher education administrators, doctors and psychiatrists at state institutions, prized college professors, and persons working extraordinary amounts of overtime. Texas spends about $600,000 a year for foreign travel. It spends enough reimbursing employees for using their own cars to pay for 243 round trips to the moon.

Possible Problems: Texas legislators are understandably enthusiastic about the prospects for a session involving few tax increases and none noticeable to the public. A session that produces widely hailed cost-cutting is also a delightful prospect. But the session is likely to have difficult aspects as the legislature works through the nitty-gritty of the budget. One major concern is prison construction, with a large and expensive program likely. Another will be the costs of social service programs, which aren't likely to be greatly affected by reorganization.

HEALTH CARE COSTS

Health Costs: Rapidly rising health care costs continue to put immense indirect cost pressures on Medicaid, as well as increasing pressures for federal and/or state action. The major indirect effect appears in escalating costs of employer plans. The higher costs discourage employers that don't offer plans from adopting them and encourage employers with plans to drop them. For plans remaining in effect, the higher costs encourage employers to use larger copayments and exclude more coverage, putting Medicaid at risk when employees incur bills they cannot pay. They also encourage employers to make family coverage optional, an option often rejected when expensive to the employee. Finally, they encourage employers to increase employee cost sharing, leading some to drop their coverage.

Many illustrations could be chosen. The recent filing of Empire State Blue Cross and Blue Shield for the New York City area has higher numbers than elsewhere, but illustrates the problems. The state insurance department must approve the rates, but is likely to do so or at least approve rates that generate about the same total revenue for Empire State. To deal with competition from private companies, the firm will stop offering a blanket rate for all group coverage. So groups with good risks will pay just over $5,000 an employee-year for family coverage, a decrease of about 15%, while groups with more risk will pay about $9,000 an employee-year, an increase of about 50%. A typical individual policy will be about $11,000. Empire raised its rates about 20% this spring and 14% last year.

Medicaid Costs: There is no evidence of any slackening in the cost pressures on state Medicaid programs. The revised federal budget estimates released by OMB in July presume a 16.2% increase in FY 1992 federal Medicaid costs, which implies a nearly identical percentage increase for state spending. Pressures to raise reimbursement rates continue as health care providers increasingly turn to the courts.

Medicaid Expansion? When federal officials, health care provider groups, and those concerned with reducing the number of uninsured consider policy options, Medicaid expansion often rises to the top.

Four major health organizations -- representing doctors, hospitals, Blue Cross and Blue Shield, and health insurers -- recently have endorsed Medicaid coverage for an additional 10 million people who are below the poverty level and don't have other coverage. An advisory panel appointed by the President is reportedly moving toward a similar recommendation.

A continuing expansion of Medicaid is one of three choices in a new Congressional Budget Office study, Selected Options For Expanding

Health Insurance Coverage. The other two are mandated employer coverage and a combination of more employer coverage and more Medicaid coverage. Under the Medicaid option, all persons below poverty income levels would get free coverage. Those with incomes between 100% and 200% would "buy in" to Medicaid with a sliding scale of contributions. The Medicaid option would increase recipients from 14.6 million now to 25.3 million, plus another 6.8 million that would have Medicaid coverage on top of Medicare or private health insurance coverage. Under current cost sharing arrangements, the Medicaid expansion would cost states nearly $12 billion. CBO says this "would cause a major funding crisis for the states."

The study has a table showing what the aging of the population will do to Medicaid costs. In 1991, the average cost for female recipients -- there are slight differences for males -- was $656 for recipients under age 18. This rises to $1,382 for those in their late 30s, to $2,077 for those in their late 50s, and to $4,128 for those over 65. States pay about 43% of these costs with state shares as high as 50% in more affluent states and below 20% in the less affluent.

Another CBO study, Policy Choices For Long-Term Care, addresses specifically the costs primarily associated with serving an elderly population. Over three-fourths of long term case costs were in nursing homes. Medicaid pays about half these costs. Medicare, which doesn't cover long term stays, covers only about 2% of the nursing home bill. The rise in the elderly population alone suggests Medicaid costs will escalate, but the prospects for cost-containment are "bleak" because individuals are already required to exhaust most of their own resources before using subsidized care and the range of subsidized services is narrowly defined.

As with the case in the CBO health insurance study, many of the options would increase costs for states. One would mandate a minimum personal needs allowance, the amount a patient is allowed to keep. Another would broaden eligibility by mandating a change in the income thresholds. Steps to broaden the use of home health care would have uncertain effects -- cutting costs by diverting persons from nursing homes and increasing costs by providing help to people who don't now receive Medicaid services.

The report also considers broader options for altering the federal-state division of responsibility. One would shift responsibility to states along with a block grant. The other would provide for increased federal responsibility for the long-term care population.

BOOTSTRAP FINANCING AT RISK

Increased Use Bootstrap Financing: Medicaid bootstrap financing (Issue 14), an increasingly key means of financing state Medicaid matching funds, remains under attack. The returns are still coming in, but it is clear that a substantial interest in bootstrap financing coincided with the need of end-of-session negotiators to find new revenues in politically acceptable ways. This resulted in bootstrap financing devices being adopted with little notice or debate.

The latest example is Washington, where legislators ended their regular session with a teachers' strike and without a budget agreement. Everything came together in late June when added money appeared from a revision of the revenue estimate and a decision to rely on bootstrap financing. In Kansas, the Finney Administration has announced that a $30 million windfall may conveniently match a $20 million problem created by a judicial decision requiring continuation of public assistance to some recipients cut off in the FY 1992 budget. The chairman of the Senate Ways and Means Committee cautioned that the federal "loophole" would probably be closed soon and expressed concern about using the added purchasing power for welfare rather than health care.

One state budget official, speaking off the record, called the action in the states a "feeding frenzy." He said his state would never have made the spending commitments it did "if the money hadn't seemed free." In his large industrial state, bootstrap financing provided enough money to "delay the day we come to some kind of reckoning" with spending patterns that seem to exceed available revenues. In Illinois, legislators moved through July without a budget, but had no trouble accepting a $300 million item to be financed with hospital fees to help close the budget gap.

In states that have used provider taxes or donations for several years, the costs of the program are growing as the practices become more familiar to, and accepted by, state officials and health care providers. In Georgia, the governor recently announced that $242 million will be allocated to hospitals this year. This is up from $88 million in FY 1990. Arkansas is using the money from its new dedicated tax on providers to restore Medicaid benefits for those not receiving cash assistance (the medically needy). Their coverage was dropped last year for fiscal reasons.

The Coming Battle On Bootstrap Financing: ***Bootstrap financing seems destined to be the issue of the year in state-federal relations in 1992.*** Many states have enough money at risk so that the outcome could mean the difference between raising taxes or not in the 1992 legislative sessions.

Images Of The Practice: In arguing with federal officials, state officials will be at an initial disadvantage because of poor images of the practice in the press and media. An example is "How States Cook The Books: Step 1: Inflate Medical Fees. Step 2: Make Uncle Sam Pay For Them," U.S. News (7/29). The magazine quotes Maryland officials as calling the practice "Fool the Feds" and also uses **Report**'s non-pejorative phrase "bootstrapping." Officials of other states have used phrases like the "second Massachusetts miracle" and the "Massachusetts loophole." The Seattle Post-Intelligencer (6/30) called use of the plan to balance the new Washington budget a "Medicaid gimmick." Columnist Donn Tibbetts of The New Hampshire News (6/30) reviewed the state's budget with the conclusion, "Some would say the budget is a house of cards including a quick Medicaid shuffle."

But adverse characterizations of bootstrap financing don't lead to avoiding it, at least from a state perspective. In Illinois, where the governor has reservations about the practice, he was under considerable pressure to adopt it both to balance the budget and satisfy health care providers. The Chicago Tribune commented (6/27) editorially, "It's foolish for Illinois to be giving up millions of dollars to which it is entitled because of disagreements over how to collect it and use it well."

The State Perspective: State officials continue to oppose restrictions on bootstrap financing. Such restrictions are considered likely to come from federal executive branch agencies soon, with an effective date when the Congressional moratorium on them ends at the end of the year.

The National Conference of State Legislators emphasized that the major factors causing escalating Medicaid costs were recession and caseload growth. federal mandates, and escalation in health care costs. NCSL's executive director indicted that "state use of provider taxes and voluntary donations is not a significant factor in the increased cost of the Medicaid program." The National Governors' Association executive director predicted that "Medicaid's role as a payor of last resort will continue to grow." The two groups and forty other national associations issued a statement encouraging federal decisions leaving states flexibility in Medicaid finance. The groups included business (NAM, U.S. Chamber), providers (hospitals, nurses), local governments (counties, cities), and labor (AFL-CIO, AFSCME).

Assessing Bootstrap Financing: There is no obvious upper limit on federal Medicaid outlays if there are no constraints whatsoever on bootstrap financing. Provider reimbursement rates could be raised with the extra income divided between the states (to use as a match and perhaps to keep some for other Medicaid financing) and the providers. Given this situation, provider rates for Medicaid could quickly rise to some benchmark, such as Medicare rates or rates charged private patients covered by health insurance. That implies an increase of 15-30% depending on the state and providers. In addition, states might well be motivated to increase eligibility for Medicaid coverage which could easily add 50-100% to participation and thus to cost. Federal officials will no doubt argue that such results are fiscally unacceptable and poor health care policy.

The broad state case for bootstrapping includes arguments like: (1) states need the money, (2) Medicaid costs are growing too rapidly so the federal effort should increase, and (3) the federal mandates are responsible for much of the increase in costs. A separate argument is that while the federal government can prescribe state matching, it shouldn't be prescribing a state's choice of which taxes to use. Many state officials feel strongly about this argument and have won some major issues, such as defeating a proposed tax treaty in the Senate over its provisions on state use of unitary treatment of corporate income.

Possible Outcomes: It seems likely that before the dispute is over, there will be consideration of compromises that reflect: (1) the federal desire for protection from unlimited cost escalation and (2) preservation of the state's taxing power. Anything considered along these lines would involve considering the continuum of bootstrap financing arrangements.

At one end of the continuum is the pure donation program designed to have absolutely no impact on state finances. In those programs, in substance, a provider such as a hospital puts money into a program voluntarily on the assurance that it will get its money back and then some. No sacrifices are involved for the state's taxpayers, other providers, patients, or any actor other than the federal taxpayer.

At the other end of the continuum is a tax on some economic activity not per se related to Medicaid reimbursement. Examples are taxes on gross receipts of hospitals, pharmacies, or nursing homes. These taxes inherently involve sacrifice on the part of a state's taxpayers, providing political controls over excessive use. Expecting federal clampdown on bootstrap financing, some states have tried to structure their programs more like these forms of taxes and less like donations.

A conceivable evolution of the Medicaid program would resemble what happened 20 years ago with another federal program when state ingenuity indicated it was nearly open-ended. This was the "Title XX" program -- Medicaid was Title XIX of the same legislation. It provided 75% federal reimbursement of social service spending. A few states, such as Illinois, were creative in qualifying many activities already taking place and using money already being spent as the 25% match. Other states began to follow, with federal costs escalating rapidly.

The result was ultimately a federal social service block grant program with a per capita ceiling set at about what the heavy participants were spending.

A Medicaid block grant isn't totally far fetched. The concept has been around since the discussions on sorting out state and federal roles in the early 1980s. Coincidentally, Hawaii, which is far ahead of other states in providing health care to a large percentage of its population, is looking for a special waiver to turn its Medicaid allocation into a block grant.

ORGANIZING PUBLIC WORKERS

Organized Labor In State And Local Government: Some trends in the economy, such as a reduction in the relative role of large manufacturing plants as employers, haven't favored labor organizations. But their popularity with state and local employees has grown, as has the number of employees, making public sector unions a major and growing force in the union movement.

Nationally, about 45% of state and local workers belong to labor organizations according to information just released by the Census Bureau shown in Table 1.

Table 1: Percentage of State And Local Workers Organized, 1987

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	85.8%	18	Delaware	53.4%	34	Arizona	30.3%
2	New York	76.0	19	Vermont	46.2	35	Oklahoma	30.0
3	Massachusetts	75.5	20	Montana	45.9	36	Missouri	29.8
4	Connecticut	73.8	21	Utah	45.8	37	Alabama	29.2
5	Rhode Island	72.2	22	Nevada	45.4	38	Tennessee	27.7
6	Minnesota	69.8		**United States**	**45.3**	39	Wyoming	26.5
7	New Jersey	68.0	23	Illinois	45.2	40	North Carolina	24.9
8	Michigan	65.5	24	North Dakota	44.9	41	Kansas	24.1
9	Alaska	64.0	25	Ohio	43.7	42	Virginia	23.1
10	Maine	62.3	26	Iowa	39.5	43	New Mexico	22.7
11	Pennsylvania	61.0	27	Florida	38.3	44	Louisiana	22.5
12	Washington	58.6	28	Nebraska	37.2	45	Texas	21.0
13	Oregon	57.5	29	Colorado	34.2	46	Kentucky	20.8
14	Wisconsin	56.3	30	Idaho	33.5	47	Arkansas	17.9
15	Maryland	54.7	31	South Dakota	33.0	48	Georgia	15.8
16	California	54.6	32	West Virginia	31.0	49	South Carolina	15.6
17	New Hampshire	54.2	33	Indiana	30.5	50	Mississippi	8.3

Northeastern states and Hawaii show much higher percentages than Southern and Western states. This is consistent with other geographic patterns regarding organized labor, such as right-to-work laws and right-to-bargain laws for state and local government. The former are most often found in the South and West and the later in the Northeast.

State government patterns are similar to the state and local patterns shown in Table 1, but are not identical. The state data appear in Table 2.

Table 2: Percentage of State Workers Organized, 1987

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	83.1%	18	Oregon	46.5%	34	Oklahoma	20.0%
2	Hawaii	82.7	19	Delaware	42.3	35	West Virginia	19.9
3	Minnesota	81.7	20	Maryland	42.0	36	South Dakota	18.0
4	Rhode Island	81.0		**United States**	**39.7**	37	Virginia	17.6
5	New York	78.5	21	Washington	38.3	38	Louisiana	16.7
6	Massachusetts	77.0	22	Colorado	37.5	39	Wyoming	16.3
7	New Jersey	71.3	23	Illinois	35.1	40	Arizona	15.6
8	Maine	70.7	24	North Dakota	34.7	41	Arkansas	15.5
9	Alaska	68.1	25	Utah	34.0	42	New Mexico	15.4
10	Michigan	60.1	26	Nevada	32.5	43	Missouri	15.1
11	New Hampshire	58.7	27	South Carolina	31.1	44	Nebraska	14.3
12	Pennsylvania	54.9	28	Tennessee	29.2	45	Texas	14.1
13	Montana	54.0	29	Idaho	29.0	46	Indiana	12.1
14	Wisconsin	49.1	30	North Carolina	22.9	47	Kansas	11.3
15	Ohio	47.9	31	Georgia	21.8	48	Florida	10.7
16	Vermont	47.8	32	Iowa	21.7	49	Mississippi	9.1
17	California	47.3	33	Alabama	21.2	50	Kentucky	2.1

The typical pattern is for a higher percentage of local employees to be organized than state employees. As a result, the state and local percentage organized (Table 1) exceeds the state employee percentage (Table 2) by 5.6% nationwide. In extreme cases -- Florida, Nebraska, and Washington -- the spread is over 20%. In some states, the percentage of state workers organized is higher than that of state and local workers combined, particularly in South Carolina (15.5% more state), Minnesota (11.9%), and Connecticut (9.3%).

MISCELLANY

Bridgeport Bankruptcy: The federal judge with jurisdiction over Bridgeport's attempt to obtain bankruptcy protection has rejected the contention of the State of Connecticut that the city has no authority to file for bankruptcy. The decision rests on Connecticut law on the powers of municipal corporations. For other states, particularly home rule states, it suggests that if state officials want to preclude local bankruptcy filings their laws should say so explicitly. The next issue for the court is whether the city is really insolvent.

Budget-Balancing Devices: New York's comptroller has been particularly critical of this year's state budget agreement -- in the process coining two new terms for fiscal practices he doesn't like. It is common for fiscal authorities to be concerned about funding ongoing expenditures with one-time measures such as revenue acceleration, spending delays, and sale of assets. Comptroller Regain has been critical of the device of using the Thruway Authority bonding power to fund grants to New York local governments, which he calls "a sophisticated, albeit presumably legal, money laundering scheme." But the practice could be followed year after year, so he calls it a "recurring one shot." He is also critical of the tendency of the New York legislature (and other legislatures) to resolve difficult end-of-session issues by appointing commissions to deal with them. He calls these "Let's Adjourn commissions designed to allow legislators to say something has been done so they can get out of Albany."

Farm Property Values And Taxes: The farm financing crisis of the early 1980s appears to be over. As farm prices dropped from a national average of $689 per acre in 1984 to $513 in 1986, some farmers found they could neither make their mortgage payments nor get out from under by selling their mortgaged land. Some states established special programs to try to help them. Since 1986, farmland prices have been relatively stable, so there is little discussion of the state programs.

The federal government spends large sums gathering detailed data about agriculture including an annual series on farmland and buildings by state. Not surprisingly, farmland with rich soil, proximity to markets, and plenty of water goes at a higher price than other farmland, particularly when conversion to urban uses is possible. In 1991, an average acre in New Jersey was worth just over $4,000. Corn belt land in states like Illinois and Iowa was about $1,000. The best buys are in Wyoming, where land averages $131 an acre, or Nevada at $168. Farmers in these states own lots of acres. The average Nevada farm is worth $779,640 versus $314,427 nationwide.

One aspect of these data of particular interest is a comparison of the taxes paid on farm acreage to the market value of the property. Budget constraints have eliminated the prospect of getting this information from the Census Bureau, so the farm survey is the only choice. Because states differ in the taxes they apply to farms versus other kinds of property, the farm tax burdens are not a proxy for tax burdens generally. Table 3 shows the taxes on farm property as a percent of value in 1989.

Table 3: Farm Property Taxes As Percent Of Market Value, 1989

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Michigan	3.29%	17	Ohio	0.75%	34	North Carolina	0.44%
2	Arizona	1.97	18	Massachusetts	0.70	35	Maryland	0.40
3	Wisconsin	1.96	19	North Dakota	0.65	35	Tennessee	0.40
4	New York	1.79	20	Hawaii	0.63	35	Utah	0.40
5	Nebraska	1.27	21	Colorado	0.62	38	Arkansas	0.37
6	Illinois	1.15	21	Idaho	0.62	39	Missouri	0.36
7	Vermont	1.13	21	Washington	0.62	40	Oklahoma	0.35
8	Iowa	1.02	24	Indiana	0.60	41	South Carolina	0.34
9	South Dakota	0.97	24	Montana	0.60	42	Mississippi	0.30
10	Oregon	0.96	26	Kansas	0.59	43	Nevada	0.29
10	Rhode Island	0.96	27	Florida	0.58	44	Kentucky	0.26
12	Maine	0.86	28	California	0.57	44	Louisiana	0.26
12	Pennsylvania	0.86	29	Connecticut	0.56	46	New Mexico	0.22
14	New Hampshire	0.85	30	Georgia	0.53	47	Alabama	0.16
15	Minnesota	0.82	31	Texas	0.49	48	West Virginia	0.15
16	New Jersey	0.81	31	Virginia	0.49	49	Delaware	0.07
	United States	**0.76**	33	Wyoming	0.48	50	Alaska	n.a

There is a reasonably close, but not perfect, correlation between high property tax burdens shown in Table 3 and high property taxes by other measures such as property tax effort (States In Profile, Table D-21) and property taxes as a percentage of personal income (D-9). The lowest taxes are in Southern and Southwestern states. The highest are in the Midwest and Northeast, particularly New York.

Housing Starts: Home builders are complaining with increasing intensity that their industry is being devastated by multiple factors. The recession hurts overall demand for new homes. Restrictions on timber cutting drive up prices, perhaps as much as $3,000 a house. And restrictions on bank lending and banker caution dry up credit. For whatever reason, nationwide starts through May this year are down 28% from the same period a year ago. The change in selected states shown in Table 4 provides evidence that the one-year change is highly unevenly distributed.

At least three factors are affecting the state-by-state results. First is the overall health of a state's economy, with the Western states doing comparatively well. Second is whether the local housing market was already depressed in 1990, so it didn't have far to fall. This is why some of the Midwestern states and Arizona beat the national average. Third, the reverse of the second, is whether the local economy had been booming -- the bigger they are, the harder they fall. This is part of the explanation in California and Nevada, which still have high levels of housing starts relative to population.

Sharp declines in housing starts and other construction cascade through a state's economy because many other purchases are associated with construction and moves into new homes and offices.

Table 4: Percent Change In Housing Starts Through May, 1990-1991

State	Percent	State	Percent	State	Percent
Utah	22%	New York	-23%	Nevada	-32%
Colorado	16	Ohio	-25	Florida	-34
Texas	-8	Connecticut	-28	Oregon	-37
Pennsylvania	-15	**United States**	**-28**	Maryland	-38
Arizona	-16	Virginia	-30	Washington	-40
Georgia	-18	Illinois	-31	California	-46
Michigan	-22	Massachusetts	-31	New Jersey	-52

Kudos: Utah's economic development gets favorable reviews from Time (7/29) with the quality and low cost of the workforce considered the key to its success. Forbes (8/5) celebrates the achievements of "forceful young" Governor Weld in "The Boston Supply-Side Party." It likes repealing the sales tax on professional services, cutting the budget, blocking universal health insurance, closing mental health institutions, and the new R&D credit in the corporate income tax. The unknowns are whether the FY 1983 budget can be balanced given the one-time items used to balance FY 1992 and whether the governor can, "as promised, save money by running government more efficiently."

The 45 best hospitals in America are selected by U.S. News (8/5). Practically all of those selected are private, not-for-profit ones -- excluding profit-oriented hospitals, local government hospitals, and state-affiliated hospitals. The local and/or state-affiliated hospitals among the 45 include five in California: four associated with California state universities and one with Los Angeles County and the University of Southern California. The others are the hospitals associated with flagship state universities in Iowa, Michigan, Texas, and Washington.

USA Today (7/17) got responses from 37 governors to a request to pick five of their colleagues "who have done the most for education in their states." Winners: Campbell (SC), Clinton (AR), Gardner (WA), Romer (CO), and Wilkinson (KY). Other results suggested preferences for providing more social services through the schools, less rigid teacher certification requirements, and more choice of schools for students and their parents. Governor Gardner's education leadership appeared more prized nationally than at home as the Washington legislature failed to adopt his education reform proposals in a recent special session. Governor's aides blamed partisan politics for the defeat. Opponents blamed the plan.

It's kudos of a sort -- New York's governor has offered political asylum to Connecticut's governor who is associated with the proposed new income tax, closing down state government, and inability of the state's elected officials to resolve the state's tax policy and fiscal plan. Governor Weicker has a few quips of his own including, "Nobody every told me this job would be easy, and nobody lied." Also kudos of a sort: when Weicker went on television in mid-July to explain the need for an income tax, his ratings matched such popular programs as Jeopardy and Entertainment Tonight.

Texas Governor Richards was booed and the target of a few thrown beer cans at a Fourth of July event. The problem probably had nothing to do with public policy. A city council member in Austin, where the incident occurred, commented: "I would never, as a political figure, get up and give a speech in front of a crowd that had been drinking beer for eight hours, listening to a rock concert and waiting for fireworks."

New Laws: July 1 was the effective date for most new state laws. Many of the new taxes took effect on different dates, basically as soon after passage as possible. So quick-acting states started collecting new revenues in FY 1991 while slow-acting states used effective dates like July 15 and August 1. Many of the income tax increases are retroactive to January.

Not all subjects were equally weighty. Arkansas made the square dance the official state dance. It is now illegal to let thistle go to seed in Boone County, but apparently OK in other Arkansas counties. Henceforth in North Dakota, those who advertise buttered popcorn will have to use real butter. In Idaho, the hallucinogenic drug peyote can now be legally transported, but only for use in religious ceremonies and only by members of the Native American Church. Arkansas opted to exempt sales of Christmas trees from the sales tax, while raising the fee for sellers of contraceptives.

For some reason lost in history, New Jersey has been giving local school superintendents lifetime tenure, like college professors. The good news for local school boards is that the state will join 49 others in not requiring this. The bad news is that the state will require they give long term contracts. Kansas has a new mandate of kindergarten programs. All districts have them but advocates sought and got state help to prevent them from being cut back.

Not all the Texas legislation made it into law. Governor Richards vetoed 36 bills so far this year. Some of the topics: expelling students for having knives, limiting witness fees, private club liquor licenses, boll weevil eradication, and exempting "street rod" vehicles from state vehicle inspections.

New Workweek: Maryland employees will shift from a 35.5 hour workweek to 40 hours after employee unions failed to obtain a court order to prevent the governor from implementing the decision. Maryland was one of only a few states that have standard weeks of less than 37.5 hours.

Productivity And Infrastructure: The idea that slumps in private sector productivity growth are caused by underinvestment in public sector infrastructure is appearing frequently in state debates on public works spending and federal debates on increasing gasoline taxes. There is considerable controversy among academics (see Technical Notes) about whether there is evidence of any relationship. While there has been some interest in the concept in some states, it doesn't seem to have triggered major changes in policy.

Retirement And Taxes: Retirees are a major development plum for states that attract them. They contribute substantial taxes and purchasing power while making minimal demands on public services. Money (July) assesses the tax climate of ten leading retirement states and concludes, "Retire to Florida, Not California." For its typical couple with a retirement income of about $35,000, state and local taxes range from $1,634 in Florida to $3,718 in California.

Much more than comparable calculations for mobile business executives, the retiree tax calculation is highly subject to assumptions about the household. What portion of income comes from Social Security, public pensions, private pensions, interest and dividends, and capital gains matters considerably. So does the local community into which a retired person moves. One factor that is uniform statewide is whether the state adds an estate or inheritance tax to federal taxes. Most states don't but some, like New York and Pennsylvania, do. Repealing the Massachusetts one is part of the governor's agenda for improving the state's economic climate.

Sales Tax Base Broadening: It has been a mixed year for the concept of broadening the base of the sales tax. The concept is popular with executive and legislative staffs almost everywhere, so it was automatically on the agenda for any state considering raising revenue. In some cases, such as California and Maryland, it has been on governor's agendas. In others, like Texas, it emerges from special reports of study commissions and legislatively generated alternatives. In yet others, some proposals appear for the first time in conference committee deliberations, as happened in Ohio.

Quantitative returns aren't in yet, but it appears that many states will show significant revenue from base broadening. All will be incremental, adding a few items, rather than sweeping.

The most sweeping proposals were made by the governor of Kansas (rejected but she's not quitting) and as alternatives to income tax proposals in Connecticut and Texas, where decisions haven't been made. There were two setbacks. Massachusetts repealed its tax on professional services which was in effect only for a day. New Jersey repealed two components of its broadened tax base: (1) trucks and truck parts because Garden State firms were losing business to other states and (2) paper products because of voter resistance. Taxing toilet paper became the symbol of tax resistance.

The National Association of State Budget Officers (444 North Capitol St., NW, Washington, DC 2001) has released a 16-page review, The Revenue Potential Of Taxing Services. Using data from Georgia, New Mexico, and Tennessee, the study shows that services are rising as a portion of economic activity and that the growth is partly captured by broad-based service taxes (New Mexico). However, from 1980 to 1990, all three states experienced a reduction in the ratio of taxable sales to personal income. The report concludes:

> States are currently in a situation where their tax systems cannot generate adequate resources to fund ongoing services. In a slow economy, states must consider all available options for both taxing fairly and providing essential services. Expanding the sales tax base to include services, and putting the service sector on even footing with the goods-producing sector, would be a positive first step.

States With No Budgets: State Budget & Tax News counted nine states without enacted budgets at the July 1 beginning of the year: California, Connecticut, Illinois, Louisiana, Maine, Massachusetts, North Carolina, Ohio, and Pennsylvania. In addition, states with late-beginning fiscal years -- Alabama (Oct.), Michigan (Oct.), and Texas (Sept.) -- didn't have FY 1992 budgets. Most of these states resolved outstanding issues in July with little or no disruption of state activity. Most, like Ohio, had experience in running into the new fiscal year and had adequate cash to manage the situation. The primary exception was Maine which had nationally publicized disruptions.

This left five states without budgets including the three that aren't yet at the beginning of their fiscal years. In Connecticut and Pennsylvania, there were substantial disruptions including missed payrolls in Pennsylvania and closed state facilities, including parks on the July fourth weekend, in Connecticut. In each of these cases, temporary appropriations (continuing resolutions) have become a bargaining chip in the substantive negotiations.

TECHNICAL NOTES

Clawing And Scratching For Development: The numbers associated with big-deal economic development investments are always in dispute. Those used in the article should be viewed as order of magnitude, and not closely comparable from deal to deal. In every case, there are four critical variables beyond unknowns associated with the investment itself, like how many people will be hired. They are: (1) the rate of interest used to discount costs to present value, (2) the extent to which new employees come from out-of-state, (3) the number of secondary jobs, the multiplier, and (4) the extent to which investments, like providing roads to a plant site, are viewed as part of an incentive package versus normal state programming. Different assumptions are made from state to state and even within a state. In Colorado, for example, analyses by proponents of the larger United deal and a legislative staff analysis showed different cost-benefit results largely because of differences in the second assumption.

Reports had no reason for singling out Oregon as an example of this year's legislative activity other than its Joint Legislative Committee on Trade and Economic Development (State Capitol, Room 132, Salem, OR 97310) sent its summary of 1991 Major Economic Development Legislation about the time the development article was being written. The third edition of NADA's efforts is Directory Of Incentives For Business Investment And Development In the United States: A State-By-State Guide (Urban Institute, 1991).

Miscellany: Farm property information, including taxes, is from the U.S. Department of Agriculture's Agricultural Resources: Situation And Outlook Report (June 1991). Housing start information is collected by the Census Bureau and published in the Current Construction Reports series. The National Association of Home Builders calculates change rates in Housing Economics (July 1991).

The data on organized labor in state and local governments comes from the 1987 Census of Governments: Volume 3: Public Employment: Number 3: Labor-Management Relations published in June 1991.

The most recent criticism of the concept that public infrastructure promotes major improvements in private productivity appears in articles in the Federal Reserve Bank Of St. Louis Review (March/April and May/June) by John Tatom of the bank's staff. The case for the concept appears in articles by David Aschauer and others that are cited by Tatom. The subject is covered in a 250-page book, Is There A Shortfall In Public Capital Investment? published by the Federal Reserve Bank of Boston and edited by Alicia Munnell of the bank.

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The clash of adamant no-new-tax stands with apparently growing reasons for tax increases was conspicuous in the Midwest this year. The issues were national in scope. The outcomes varied.

- o State Policy In The Industrial Midwest p. 5

State insurance regulators are facing major problems with insolvent insurance companies. California and New Jersey have assumed control of companies with policyholders nationwide.

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The Texas legislature has acted to implement many ideas of a 1,000 page report on cost cutting. It has recommendations that may be followed in other states.

- o Money-Saving Ideas p. 11

This year produced a potpourri of policy issues associated with taxing health care and other providers, production equipment, "free" goods, and mail-order sales. Also at issue: earmarked taxes and ending sales tax exemptions.

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August 1991 (Second of Two August Issues)

STATE FINANCIAL OUTLOOK

Introduction: State legislatures have just concluded the most active budget sessions in decades. They were active as measured by tax increases, time devoted to fiscal subjects, and extent to which policies affecting all departments and functions were controlled by fiscal considerations. Everywhere the next question is the same: Will the actions taken in 1991 solve the problems, or is another round of difficult fiscal politics coming next year?

Status of 1991 Actions: By late August, all but two legislatures had acted on budgets for FY 1992.

One exception was Connecticut where the legislature has passed three budgets only to see them vetoed. Parks and offices closed in July, as continuing resolutions to keep them open themselves became a subject of controversy. The major issue remains whether to adopt a personal income tax, as the governor proposes, or try to get along without one. The three budget and tax bills avoided an income tax by increases in the sales tax rate, or sales tax base, or both. They included other revenue-raising measures and financing changes, including one-time measures which the governor argues would cause continuing financial crises. The last measure to be vetoed had 128 different revenue-raising provisions.

The other exception is Michigan where the new fiscal year doesn't begin until October 1. The potential for stalemate is great, as indicated by the fact that it took until this summer to resolve adjustments to the current year budget. Newly elected Governor Engler (R) has been pushing for no tax increases, a local property tax limit, and sharp spending cuts to make the first two possible. Many of the spending cuts have produced extensive opposition in and out of the legislature. A tentative leadership agreement sets spending increases at about the inflation rate and avoids tax increases, but only by such potentially controversial measures as selling the state liquor stores and eliminating $45 million of revenue-sharing with local governments.

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While legislative consideration of the budget is basically complete in the other states, many legislatures have work left to do. There have been substantial gubernatorial vetoes for legislative consideration in such states as Alabama, Illinois, Minnesota, Ohio, and Wisconsin. Legislative reconsideration of aspects of the budget bills that were recently passed is expected in California. A special session to reopen tax issues could take place in Tennessee.

Voter approval is needed to finish the budget process in Missouri, where tax measures are on the ballot in November. Several states have lottery votes. Miscellaneous budget-related measures have been or will soon be on the ballot elsewhere, such as the August Texas vote on property tax exemption procedures that are associated with the revision in school finance by the state.

Summary Of The FY 1992 Budget Actions: The preliminary fiscal survey released by the National Conference of State Legislatures in mid-August reflects the fiscal problems and tax increases observers have been reporting since spring. Spending is budgeted to rise at 4.2%, about the inflation rate. Revenues, fueled by tax increases, will grow about 8.3%. The difference will restore balances somewhat, to a projected level of 2.6% of spending up from 1.9% at the beginning of the year.

When all the returns are in, including states not in the NCSL survey, the state tax increases will likely fall in the $16-20 billion range. This is the largest tax increase ever and the largest as a percentage of state budgets since 1971. As previously reported, the increases weren't concentrated on any one tax source. Personal income, sales tax rates, sales tax base, corporate income, gasoline, cigarettes, and more were all reached.

The Outlook: In releasing the survey, NCSL commented, "the depressed condition of state finances is likely to continue." How bad next year's situation might be depends on several factors, particularly: (1) revenue prospects affected by the national economic outlook, (2) revenue affected by federal Medicaid reimbursement policy, (3) how much spending exceeds estimates, and (4) how deep a hole officials of some states may have dug for themselves. As usual, there are also factors unique to some individual states -- school finance cases, Oregon's property tax limit, Nebraska's property tax discrimination problems, etc.

Revenue And The National Economy: National economic performance is the major unknown in assessing the state fiscal outlook. State estimates, like federal ones, presume economic recovery in FY 1992 with an annual economic growth rate (real GNP) of about 3%. It is possible that this rate will not be realized or that revenues won't perform as anticipated because of taxpayer behavior -- such as buying more untaxed services and less taxed goods. Individual state economies may perform worse (or better) than anticipated even with a correctly anticipated national economic climate.

Preliminary results aren't encouraging. There have already been revenue shortfalls and sometimes cutbacks in Florida, Georgia, Idaho, Maryland, Missouri, Montana, and probably other states. On the other hand, some states such as Massachusetts are reporting more favorable revenue results than anticipated.

Revenue And Medicaid Reimbursement: As discussed elsewhere in this issue, the states are in imminent danger of losing expected federal Medicaid reimbursements. These revenues are a part of the revenues anticipated for this fiscal year and beyond in state fiscal plans. Their loss would force reconsideration of fiscal plans and enacted budgets. The options are: (1) replacing the revenue by new tax measures, (2) cutting Medicaid spending, (3) cutting other spending, (4) searching for more one-time measures, and (5) combinations of these.

Spending Underestimates: Again in FY 1991, states spent massively more for Medicaid and corrections than legislatures appropriated when the budgets were initially enacted. The NCSL survey shows a 23% increase for Medicaid and a 17.6% increase for corrections. The overruns are again possible in FY 1992, putting an added strain on state budgets. In addition, massive amounts of contingent liability are being built up in litigation by provider groups, particularly hospitals, on Medicaid reimbursement rates.

How Deep A Hole? Most state budgets carry some sort of fiscal momentum into the ensuing fiscal year, making the next budget tighter or more flexible than the last. In an ideal world this wouldn't happen. Instead, a multi-year spending and revenue plan would ensure that one year's patterns could be sustained in the next without building in either tax cuts or tax increases. But sometimes state officials take a one-year view of solving fiscal problems and leave problems for the following year. Conversely it is possible, by design or misestimates of revenue and/or spending, to build unexpected surpluses. The individual states don't seem to have acted consistently in this dimension of fiscal policymaking.

According to the NCSL survey, states will take in more revenue in FY 1992 than they will spend. If it happens, this will build up balances and leave a situation where revenue growth can be devoted to spending growth in FY 1993. In fact, running a surplus in FY 1992 means part of the revenue growth that builds balances in FY 1992 can fund spending in FY 1993. In other words, the NCSL figures indicate the reverse of high reliance on running down balances to manage the current fiscal year.

But the situation isn't likely to be as sanguine as those survey numbers suggest. Part of the problem is that many of the revenues are one-time ones. They include the sale of a highway to the turnpike authority in New Jersey and the sale of state property in Massachusetts. They include one-time acceleration of tax and non-tax revenues in many states. Reported spending is lower because some local aid spending has been shifted from one fiscal year to the next, creating a one-time pickup in FY 1992. Natural revenue growth in FY 1993 will have to pick up permanent financing of such one time items, leaving less revenue from existing taxes to finance normal spending growth.

Some of the state budget packages were designed to be clearly sustainable in future years without tax increases. Examples are California, Pennsylvania, and Vermont. Other states have clearly built in problems for the future. Examples are Illinois, New Jersey, and Tennessee, probably to be joined by Michigan.

Summary Outlook: The state fiscal outlooks are closely tied to what happens in the national economy. A national growth rate 3% below what state officials expected caused much of the difficulty experienced this year. State officials are expecting about 3% national growth again. If they get a disappointing 0% again, there will be problems next year like those this year. Conversely, if they get 6% or unanticipated inflation, the short-term state fiscal condition would improve markedly.

Without any surprises on the economic front, state finances in 1992 are likely to be tight, though not as tight as 1991. New initiatives will be scarce. Tax cuts will be rare, and many "temporary" enactments this year probably won't be allowed to expire on schedule next year. Besides the economy, the biggest threat will be Medicaid -- both because of potential revenue loss from federal regulations and because of higher-than-anticipated spending. This kind of tight outlook could be a pattern, affecting not just 1992 but most of the decade of the 1990s.

If this is to be the pattern, the actions of 1991 in the Industrial Midwest provide examples of what could be happening in most of the states.

STATE POLICY IN THE INDUSTRIAL MIDWEST

Introduction: In 1991, the Industrial Midwestern States provided important examples of fiscal politics and policy. In broad terms, states this year were in three fiscal situations. In one group, such as the Northeast and California, tax hikes were almost inevitable without radical changes in state policy. In another group, mostly west of the Mississippi, tax hikes were clearly avoidable and generally avoided. A third group, dominated by the Industrial Midwest, was right at the margin.

Economic Condition: The good news for the Industrial Midwest is that the recession wasn't devastating. Most recessions have hit this region harder than other parts of the country. Manufacturing has been disproportionately hit by job losses which have echoed throughout the economies of communities like Cleveland, Detroit, Gary, Milwaukee, Pittsburgh, and the Quad Cities (in Illinois and Iowa).

Reduced reliance on manufacturing, reflecting a national pattern, reduced Midwestern vulnerability to manufacturing downturns. This recession has had heavy impacts on financial services, housing construction, and defense contracting, not heavily concentrated in the region. Meanwhile, exports and agriculture have fared reasonably well to the advantage of the region. The recent rates of employment change and population of the region's states are shown in Table 1.

Table 1: Population (million) In 1990 and Employment Change (March 1990-1991) Industrial Midwestern States

State	Population	Employment Change Percent	Employment Change Rank
Illinois	11.5	0.1%	29
Indiana	5.6	-0.1	32
Iowa	2.8	1.4	18
Michigan	9.3	-2.9	45
Minnesota	4.4	0.0	31
Ohio	10.9	0.4	27
Wisconsin	4.9	0.8	24
Total/Average	49.4	-0.0	29
United States	**249.0**	**-0.1**	**n.a.**

The region lost 0.04% of its jobs while the national loss was nearly identical. The average rank in job loss was 29, but because the most populous states had the greatest unemployment loss, the national average was exceeded by 32 states. Only Michigan's employment decline was serious enough to place it in the 15 states with the most problems.

Politics: The political patterns of these states are quite similar. Four have newly elected Republican governors who campaigned on themes of economy, efficiency, and no new taxes. Two -- Iowa and Wisconsin -- have veteran Republican governors pushing the same policies. The lone Democrat, Governor Bayh of Indiana, has consistently argued for no new taxes. Democrats control the House in all seven states. Republicans control the Senate in Indiana, Michigan, and Ohio. As a result, party control is divided in each of these states.

Difficulties In Setting A Budget: Two factors associated nationally with difficulties in reaching budget conclusions this year were tight fiscal circumstances and divided party control of state government. These seven states had both. Stalemates of one kind or another caused most of them to be off schedule in their budget deliberations. Michigan had tardy adjustment of FY 1991 finances and may have difficulty in enacting a new budget by the October 1 beginning of the fiscal year. Illinois and Ohio didn't complete budget enactment until after July 1. Substantial fiscal issues were being resolved after July 1 through the veto process in Minnesota and Wisconsin. Indiana finished on schedule, but only after the regular session failed to reach agreement and special sessions were called. Only Iowa finished on schedule without special problems.

Small Tax Increases: The Midwestern governors' budgets called for no new taxes and substantial cuts, management changes, and reorganizations. In general, the budgets returned by the legislatures have less management change and more taxes than the governors' budgets. There was no increase in the rates of a major tax, except Minnesota's sales and income tax increase. But there were several close calls including serious consideration of a sales tax increase in Iowa and legislative passage of several tax increases in Wisconsin.

Illinois extended its 1989 income tax increase that was scheduled to expire and raised revenue by converting a property tax deduction to a credit. Indiana raised motor vehicle taxes that recently had been lowered. Iowa raised the cigarette and real property transfer taxes. The returns aren't final from Michigan but the local betting is against tax increases. Minnesota has increased its sales tax and broadened the base, though the tax increase is arguably a new local tax. Ohio extended the sales tax to some services. Wisconsin's legislature passed extensive tax increases that the governor has vetoed.

Other Revenue Increases: Medicaid bootstrap financing found its way into most of the seven state budgets, though the use of the device is probably less significant as a percentage of revenue than in Southern states. The other sources of non-tax revenue, such as tuition increases, were used extensively by Midwestern states just as they were throughout the nation.

One Time Measures: There was greater-than-normal use of one-time measures in these states' budgets. In Illinois, nearly half a billion is being borrowed through a state revenue bond agency to pay health care provider bills. Illinois also adopted a one-month delay in payments to school districts. Michigan leaders have tentatively approved a one-year moratorium on local government revenue sharing. Sales tax payments to the state from vendors are accelerated in Illinois and estate tax payments are likely to be accelerated in Michigan. Indiana is drawing down its balances to finance the new budget.

Spending Priorities: The no-new-tax approach taken in the seven states' budgets placed a premium on increases that seemed unavoidable, generally Medicaid and corrections. While the results are somewhat obscured in some of the budgets because of underestimates and migration of costs among fiscal years, the Ohio budget summarized in Table 2 is indicative of the pattern which will appear as the budgets are implemented.

Table 2: Increase in Ohio FY 1992 Appropriations ($ million)

Category	Dollar Increase	Percent Change	Percent of Increase
E&S Education	$62	2.1%	8.1%
Higher Education	30	1.8	3.9
Medicaid	466	14.1	60.7
Welfare (AFDC)	48	5.5	6.2
Corrections	52	10.8	6.8
All Other Programs	110	3.4	14.3
Total	768	6.1	100.0

The head of the conference committee called it a "hold-harmless, hold-the-line, minimum budget." Ohio generated a nearly no-new-tax budget, but only by holding spending growth to 6.1% or barely above inflation. Within this total, it accommodated a 14% increase in Medicaid and an 11% increase in corrections plus a caseload-driven welfare increase that was about the same percentage as the increase in the total budget. These increases ate up 74% of all the new money -- 61% for Medicaid alone. The result was increases below the rate of inflation in the other categories of the budget, particularly education.

The Outlook: Many of the states based their budget decisions this year on making sure that tax increases would not be again required in the foreseeable future. The Midwestern (and most Southern) budgets don't have this characteristic. Instead the same issues can be expected to be back in 1992, including the same debates over tax increases.

INSURANCE SOLVENCY REGULATION

State Regulation In The News: The public has been seeing state regulation at work as several large insurance companies failed. Major companies, insuring hundreds of thousands of people, have been thrown into state receivership. Some annuity holders have lost money. There are widespread fears that more losses may be on the way.

Insurance v. Other Financial Regulation: State and federal roles in regulating financial institutions aren't well understood. The underlying responsibility for regulation of any institution that holds other people's money is that of the government that charters the institution -- that permits it to operate. Thus, how much to regulate and whether to regulate has been a state decision for banks, savings and loans, credit unions, insurance companies, prepaid life care communities, health spas, prepaid funeral plans, cemeteries, and other business that take money first and promise to deliver later. There is always a risk that, by poor management or theft, such institutions will take money but not deliver later.

Over the decades, the federal government has opted to charter some institutions in these categories including national banks, nationally chartered savings and loans, and some credit unions, but not insurance companies. These nationally chartered institutions are exempt from most state regulation but are subject to federal regulation.

The dynamics of regulation gradually changed with Depression-born federal deposit insurance. The federal deposit insurance agencies could regulate insured institutions, but not all were insured. To make a long story short, many of the federally insured institutions failed, including many chartered and regulated by the states. At the same time, those states that opted to let some institutions operate without federal insurance began to experience failures as well, with nine-digit losses to state taxpayers in Maryland, Ohio, and most recently Rhode Island.

Insurance Regulation: There is no federal deposit insurance program for insurance companies, nor are they subject to federal regulation of rates or policy terms. Each state charters and licenses insurance sales within its borders. For multi-state companies, this creates complex supervisory arrangements among states.

State regulators are attempting to ensure that insurance companies don't fail. That is, that they have sufficient money to pay off all policyholders what they are due when it is due. To this end, state regulators have procedures, similar to those that failed with S&Ls and banks, to make sure assets exceed liabilities.

Gaps In Regulation: For complex reasons involving state and federal policy, there are some acknowledged gaps in insurance regulation. One is reinsurance, the business of insuring another insurance company for part of its loss exposure. Many reinsurers are offshore companies, not subject to the direct regulation of any state. Another gap is business taking the legal form of self-insurance by business associations.

Insurance Guarantee Funds: All but a couple of states have backup arrangements to pay off claimants of failed insurance companies by assessments against other companies operating in the state. These are similar to the federal deposit insurance arrangements with two important exceptions. First, in most cases the states don't actually hold the money in a fund. When money is needed there is an assessment against solvent companies. Second, some states indirectly require taxpayers, not insurance companies and their customers, to pay all or part of the assessments. The insurance companies' payments of assessments become credits against the insurance premiums tax.

There are limits to the coverage: (1) limits on dollar amounts, (2) excluded coverage such as guaranteed investment contracts and municipal bond insurance, and (3) perceived inability of the funds to pay. For example, Time (8/5) told its millions of readers that the state plans "may not be enough if a large insurance firm goes under." USA Today (7/16) headlined, "Some States' Insurance Safety Nets Precarious." It cited: (1) no coverage in the District of Columbia and Louisiana, (2) limits on coverage such as $300,000 per person, (3) no non-resident coverage, and (4) delays in payments.

Executive Life: California regulators recently announced they approved turning over Executive Life to two French investment groups. There will be policyholder losses, as many will get only 81 cents on the dollar and won't necessarily get their 81 cents on schedule. Many policyholders will have the difference covered by their state insurance funds. Customers who try to redeem policies will face a special penalty of 10% levied by the State of California. There are several complications that could cause the deal to come unstuck, including a major IRS claim and litigation by holders of guaranteed investment contracts. These GICs arguably aren't insurance and holders won't get the same recovery.

Mutual Benefit Life: New Jersey regulators took over Mutual Benefit Life, but the state was one of the few without a guarantee fund. So one was passed this summer. Besides Mutual Benefit, the legislature was responding to a threat that New Jersey Blue Cross would lose its certification from the National Blue Cross-Blue Shield Association. It was concerned that with no state fund, New Jersey could produce a situation parallel to West Virginia, also without a fund. West Virginia Blue Cross went bankrupt without coverage.

Acting to preserve policyholder assets, New Jersey regulators placed a moratorium on policy loans and honoring guarantees of over $600 million of municipal bond issues by the company.

Federal Regulation? A new round of proposals has surfaced in the Congress to shift major portions of insurance regulation from the states to the federal government. State insurance commissioners oppose the move. There have been hearings on the subject for the past several years, but no sign of movement of the legislation.

MONEY-SAVING IDEAS

Introduction: Every year there are dozens of reports about how to improve the efficiency of state government. Some are privately commissioned by groups like state chambers of commerce or leagues of women voters. Some are informal reports by task forces in the executive branch and special committees in the legislature. A few are the work of blue ribbon groups. Some are quite expensive. Connecticut spent $4 million for its reports. Most don't have much impact.

Texas Performance Review: The Texas report, Breaking The Mold: New Ways To Govern Texas, may prove to be an exception. Its timing was definitely right. The Texas Performance Review (TPR) report was presented in late June just before a legislative session faced with a budget gap of about $5 billion. Conveniently, this was about the savings over the biennium that were offered by the report. Not all the recommendations were money saving but would, in the words of the covering letter, "help transform state government into a 21st century organization committed to quality consumer service." The governor found many of these recommendations, such as substituting single agency heads for boards and commissions, to her liking. She has been pushing them along with the report's other recommendations. There was an atmosphere in the legislature that the recommendations should pass unless there were compelling recommendations for rejecting them.

The report sees a structural deficit in state finances as indicated by the current service budget estimates for the biennium. The spending levels increase 33% from FY 1990 to FY 1993 while personal income growth is expected to be only 20% and revenue will lag behind both at 17%. The recommendations to deal with the situation consume 1,000 pages. The ones that may be of most interest to readers are highlighted in this article.

Consolidating Small School Districts: Texas has had incentives for the maintenance of small districts in its state aid law. One, the "small district adjustment," is already scheduled to be phased out. TPR suggests limiting administrative reimbursements which would affect extraordinarily small districts as well as some high-spending ones. A state aid increase is recommended for aid for districts that consolidate.

Vocational Education: The report finds over 40% of vocational education programs "are in areas of no demand, gross oversupply, or both" and recommends limits on state reimbursement.

Tuition: Higher tuition reflects a major share of the total gap-closing recommendations of TPR, just as it did of the actions of many states this year. The report recognizes the extent to which the enrollment-limiting aspects of tuition, particularly out-of-state tuition, are limited by tuition waivers and suggests they be limited. In FY 1990, 19% of non-resident Texas students received waivers, including 57% at West Texas State.

Medical Education: State appropriations per student in FY 1991 were $4,271 for general academic institutions but $18,185 for nursing students, $48,051 for dental students, and $62,282 for medical students. The report makes several suggestions for cutting these costs, including taking into account some of the patient revenues earned by state university medical centers.

"Special Needs Offenders": The prison population is aging in Texas and elsewhere. Texas prisons now house over 500 inmates over age 60, about 750 impaired by mental illness, and more than 3,200 with an IQ below 70. TPR suggests that at least 2,000 beds could be freed for violent inmates by putting some of these individuals into community care or other settings. In the process, their eligibility for Social Security, Medicaid, and Medicare would be increased, further reducing state costs.

Management Versus Cost-Saving: There is a continuing dilemma in the packaging of efficiency recommendations. Management reports, like those done by loaned executives and consulting firms, often endorse management moves, such as consolidating smaller agencies or replacing multi-headed agencies with a single accountable agency head. Such moves don't normally save money in the short run. In fact, they have extra expenses for office moves and transition measures.

Often on a different track entirely are the budget-balancing moves that have no particular claim to management excellence. Some of these are generally agreed to be poor management, misleading accounting or both. Paying bills late is an example. Other budget-balancing moves just shift costs to someone else such as university students through tuition. The people who write management improvement reports are reluctant to endorse these as good management recommendations.

Sometimes elected officials try to sell the management improvements as likely to save large sums of money. **Reports** recalls examples in Iowa and Mississippi. Some claims along these lines are likely to be made in New Jersey. There are some difficulties with this approach including trying to explain why if money is being saved, the budget for the affected functions must rise.

Combining Management And Budget Approaches: An interesting strategy of the Texas report, and of the governor and legislative leaders in pushing implementation, is the combination of the pure budget-balancing measures with the management improvements. This avoids hard-to-defend claims of savings associated with the management changes. But it makes the management actions part of a package with large savings. For example, Chapter Five in the report claims $684 million in savings in the second year of the biennium. Almost all of the dollars are associated with three pure budget moves: (1) paying the state's teacher retirement bill late, (2) raising university tuition, and (3) making universities absorb some costs based on their balances and other resources. The summary then touts the benefits but notes that "the importance of the proposed changes recommended in this chapter cannot be measured by the size of their estimated fiscal effects alone."

Chapter Seven is another illustration of combining budget moves with large savings and management moves with little or no savings. Its recommendations produce a total benefit to the FY 1992 budget of $684 million. Of this, about 83% is associated with borrowing money for capital projects rather than using current appropriations. Another 17% is what amounts to a tax increase by delay of a tax exemption scheduled for machinery and equipment. The third component is the management one, centralizing debt issuance, with claimed savings of 0.013% of the savings claimed in the chapter.

In the generalizations with which the media and legislature must work, the result is pressure on legislatures to support the report, with distinctions between budget-cutting recommendations and management recommendations tending to be obscured.

Savings And The Texas Report: While the report is being considered as a cost-saving measure, those who think government spending should be cut won't find it a strong guidepost. The authors take the view, correctly, that in most state activities Texas spending is extremely low by national standards. They conclude that fiscal pressures during the oil price declines of the early 1980s put so much pressure for cost cutting on the state that "the frills, the obviously unneeded services, were gone." They also determined not to endorse reductions in "needed services." As a result, the report is mostly about how to manage better and how to raise money by taking it from other pockets. Those sources include taxpayers, balances in state funds, the financial market through borrowing, university treasuries, students, and the federal government.

In the process, however, the report left untouched a substantial number of relatively sacred cows that have come in for criticism, if not change, in other states. First, Texas has an expensive prison system primarily because it has many more prisoners in relation to population than most states, suggesting prospects for diversion programs and community corrections. Second, there may be substantial potential to reduce the institutionalized populations with mental illness or retardation by greater use of community programs. Third, like other states Texas appears to have experienced a significant decline in the productivity of university faculty (measured as student-credit-hours per faculty member) and an increase in the number of years it takes students to complete degrees. Other examples: downgrading and perhaps abandonment of some highways in sparsely populated areas, choice in elementary and secondary and higher education, and limits on employee supplemental benefits.

TAX POLICY ISSUES

Introduction: This years' legislative sessions and the Medicaid bootstrap financing issue have produced several tax policy controversies, most with ramifications beyond the state and tax immediately involved.

Bootstrap Financing Precedents: Because the discussion of federal regulations on bootstrap financing is taking place among people primarily familiar with health care finance, there doesn't seem to be much understanding of how it relates to normal state financing procedures. In this context, there are three activities falling within bootstrap financing, often called Medicaid provider taxes and donation programs. They are: (1) donations, (2) provider assessments and taxes with a base of Medicaid activity, and (3) provider taxes on a broader base.

In the first two, the provider is truly getting something for nothing. This works only if the federal government provides the additional resources. The precedents for such activities exist only within the universe of federal programs, where the practice is known as "soft match." The precedents arise when a state or local government, or more often a non-profit social service provider, counts spending it would be making in any case as a match for federal funds. The best example was the federal social service (Title XIX) program. Research or demonstration grants to not-for-profits (e.g., day care centers, community mental health centers, clinics, and universities) have also used this type of soft match. The line between donations in Medicaid and the "taxes" that use Medicaid spending as a base is very thin. In both cases, the higher reimbursement is contingent on the provider payment. Donations pay the provider when the provider donates, which is in the provider's interest to do. The tax makes the decision for the provider.

The third type of bootstrap financing differs considerably from the other two because some of the provider-taxpayers and through them certain health care customers make payments they clearly wouldn't make voluntarily. State action forces some customers to subsidize the consumption of others. ***There are many decades-old precedents for broader taxes on providers that subsidize special services for all customers within a given group.*** This financing mechanism is most often found within state-regulated businesses.

State public utility commissions regulating electric, telephone, and gas service have often established lifeline rates. These rates provide services at rates lower than charged other customers to poor persons (with a means test) or persons with low consumption who are presumed to be poor. The extra money to pay for the subsidy comes from the other ratepayers. While no "tax" is involved, the formal ratemaking procedures of the state commissions make explicit the subsidy involved, its cost to provide, and how the cost will be allocated among customers. Economically, the result is the equivalent of a tax on all consumers with proceeds distributed to the utility to fund the subsidy.

These charges aren't normally separately stated, which doesn't make them any less real. In telephone service, the new service for the deaf being implemented pursuant to a federal mandate is separately stated. In fact, states like Maryland have discovered substantial customer resistance. Some local jurisdictions use special telephone taxes to fund their 911 services.

In broader terms, considerable utility service uses the concept that everyone should pay the extra costs of serving someone with special needs. Sometimes these are related to low income service, more or less, such as the subsidies that result from rules prohibiting utility cut-offs for non-payment of bills. But another example is the extra costs of providing electric power to remote locations, which is often provided without extra charge.

State insurance regulation often subsidizes needy groups, though not necessarily the poor. Assigned risk pools work this way. All policyholders pay a premium to reduce the costs of those that would otherwise have extraordinarily high premiums, such as small group buyers of health insurance and drivers with histories of many accidents or traffic violations. State taxes for Unemployment Compensation and (in the states not relying on private insurance) Workers' Compensation use the same principle. The tax on everyone is higher because state policy caps the extent to which industries with high loss experience must cover their own costs.

Not all state provider taxes are oriented toward Medicaid matches. Indigent care, without Medicaid match, has long been an object of hospital taxes in some states including Florida, Massachusetts, and New Jersey. New Jersey renewed and modified its plan this year. The money from the hospital assessment will partly fund Medicaid match, but will also be used for activities like local health planning, a study of hospital bad debts, and supporting extended hours in community health centers.

Earmarked Taxes: When revenue sources are earmarked for a particular purpose, there is usually a connection between the source and the expenditure, such as gas taxes used for highway construction and fishing license fees used for fish stocking. Sometimes the connection isn't particularly close, such as the tendency to earmark for debt service.

The transit agency serving the Philadelphia area (SEPTA) is one of the few major mass transit agencies in the country without a dedicated tax revenue source. Most have sources like regional sales taxes or gasoline taxes. SEPTA was a winner in the Pennsylvania legislative session that just ended. What it won was dedicated revenue from statewide taxes. The $1 tax on tires and the 3% tax on auto leases have some relationship to transit, but the expansion of the 6% sales tax to magazines doesn't.

Ending Sales Tax Exemptions: As states move to limit exemptions from the sales tax, many definitional problems have been arising that raise mixed issues of economics, politics, and law.

Non-food items traditionally sold in grocery stores have been an exciting issue. New Jersey extended its tax to these items in 1990, only to watch a tax protest movement adopt toilet paper as a symbol. This year, despite difficult fiscal problems, New Jersey legislators repealed the tax on toilet paper. Presumably fearing a comparable result, Pennsylvania legislators exempted toilet paper and feminine hygiene products from the extension of the sales tax to household paper products they adopted in August.

These issues, and the frequent debate over taxing nonprescription drugs, don't involve fine distinctions concerning the food exemption. That exemption is straightforward: if you eat it or drink it, it is exempt. But legislators in states with food exemptions have shown increasing interest in carving out some traditional "food" items to be taxed.

One approach is distinguishing "drinks" from "food." A starting point is bottled water, which California will begin taxing this year. Another is "soft drinks," which creates tricky problems. For example, if orange juice is food and cola drinks are soft drinks, what are orangeade and similar items, or Kool-Aid sold in solid form to be mixed with water?

This year's excitement comes from decisions to tax "snack foods" in California and Maine. The states differed in their detailed decisions. For example, Maine will tax ice cream and nuts, but California won't.

Quibbles over definitions have their uses. Georgia was scheduled to implement a partial exemption for food this year, based on compromise definitions reportedly recorded initially on a cocktail napkin. The general thrust was to exempt fresh food (e.g., fruit) but not prepared food (e.g., Twinkies). But there were many definitional problems as well as conceptual ones, such as exempting caviar and taxing potato chips.

These issues will be back in many legislatures. In states without a food exemption (e.g., Virginia), many leaders put an exemption high on their agenda. In states with an exemption, when fiscal problems arise, legislators will again be looking at lists like household paper products, soft drinks, snack foods, and more. The issues won't easily be resolved because they concern notions of "good" foods and "bad" foods.

There is irony in these debates. The purpose of the food exemption is to avoid taxing necessities that are consumed disproportionately by the poor. But repealing exemptions on items like snack foods strikes the poor more disproportionately than would repealing all food exemptions. Concerned with this problem, some Minnesota legislators considering taxing expensive food (e.g., caviar) but not cheap food. The approach didn't go far because most food comes in expensive and less expensive forms.

Sales Tax On Production Equipment: While conceptually the sales tax is a levy on consumption, a substantial but difficult-to-measure portion of the tax is paid by producers, that is business.

Businesses buy items, by definition, solely for the purpose of reselling them or using them to produce a good or service that is itself sold. Consistent with the concept of a sales tax reaching only the final sale, states have broad sales tax exemptions for business. Purchases for resale (e.g., by a grocer from a wholesaler) and purchase of components for physical incorporation (e.g., a transmission to go into a car) are generally exempt. Practices differ more on subjects like purchases of machinery, construction materials for a plant, office furniture, and office supplies.

Many states exempt manufacturing machinery and equipment on the grounds that conceptually it shouldn't be taxed and/or that taxation would be a barrier to economic development. A few states accept these arguments partly, and tax the items at a special low rate. Texas has legislation to phase out its tax by 1995. Postponing the phase out is one of the Texas Performance Review recommendations. The Review list of the states currently taxing such sales and the rates appears in Table 3. The states marked "*" have special provisions designed to exempt machinery in some circumstances, typically if being installed as part of new plant construction or expansion. States not shown don't apply a sales tax to machinery and equipment purchases. They either have no sales tax or have one but don't tax such purchases.

Table 3: State Sales Tax On Production Equipment, May 1991

State	Rate	State	Rate	State	Rate
Washington	6.50%	California	4.75%	North Dakota	3.00%
Texas	6.25	Missouri*	4.23	Wyoming	3.00
Florida*	6.00	Georgia	4.00	Nevada	2.00
Kentucky*	6.00	Louisiana	4.00	Alabama	1.50
Nebraska	5.00	Hawaii	4.00	Mississippi	1.50
New Mexico	5.00	Minnesota	4.00	North Carolina	1.00
Utah	5.00	South Dakota	4.00		

Taxing Free Goods: An obscure controversy arising from the new California tax legislation may have nationwide significance for state taxation of advertising and even direct mail sales.

California extended its sales tax to newspapers, which is a straightforward exercise of applying the tax rate to the price charged for the paper. But the calculation yields zero tax when applied to the many papers that are free, such as suburban shopping papers, collections of ads, and the free newsstand papers found in some areas. California decided to tax some of them also. The tax base is the purchased inputs, basically the printing costs. The free papers are looking or administrative rulings and/or legislation and/or judicial decisions to block the tax.

The issue has several rounds to go. Some of the free papers are likely to convert to priced papers by charging a nominal price, like one cent. The tax on the resulting revenue would be much less than a tax on printing costs. This could also be the case for many newspapers and the slick magazines sold to specialized business audiences, where subscription revenue is often less than production and distribution costs by a substantial margin.

The discussion of taxing advertising has considered the tax base to be the sale of advertising services. For example, the base would be the payment from a consumer products company to an advertising agency. If a "free" item were taxed, then the base would be something like the production cost of a network TV show.

Taxing Mail-Order Sales: Large volumes of mail-order sales continue to escape state and local taxes, depriving state and local governments of $3 billion or so in annual sales tax revenue. Customers are obligated to pay a use tax on this merchandise, but there is no economically practicable way of getting them to pay it without cooperation of the mail-order companies. Shielded by a U.S. Supreme Court decision (*Bellas Hess*), many aren't cooperating.

State officials are backing a bill in Congress to deal with the situation. it is stalled primarily because local officials want guarantees of some of the money. Any legislation likely to pass would relieve vendors of learning all local rates and just permit a statewide rate with distribution to local governments by the state.

In this context, action of the Missouri legislature this year is significant. It repealed the local use tax entirely and enacted a single statewide use tax payable to the state of 1.5%.

MISCELLANY

Air Wars: (continued from Issue 15): Colorado's Supreme Court has affirmed the constitutionality of the incentives passed in the recent special legislative session. Kansas City voters rejected (62-38%) the extra local tax to subsidize a site for McDonnell Douglas. Neither firm has selected a site.

Bridgeport Bankruptcy: As reported in Issue 15, the federal bankruptcy judge with jurisdiction over Bridgeport's attempt to obtain bankruptcy protection rejected the contention of the State of Connecticut that the city has no authority to file for bankruptcy.

The next issue for the court was whether the city is really insolvent and thus deserving of the protection against creditors afforded by bankruptcy laws. Reflecting the position of state government and many outside critics of the city's attempt to seek bankruptcy protection, the judge rejected the city's position. This leaves the city where it was before, but poorer because of legal fees and any loss of reputation.

Bootstrap Financing Of Medicaid: The latest states to act on their budgets are being even more aggressive in adopting Medicaid donation and provider tax financing than the legislatures that acted earlier in the year. The Texas program for hospitals alone involves over a billion dollars a year in state (that is, in hospital) and federal money. Pennsylvania adopted an extensive program also.

Predicting that bootstrap financing could cost the federal government $13 billion by the end of FY 1993, federal officials have drafted a regulation to limit the practice. It would prohibit use of provider donations as Medicaid match. Taxes on Medicaid providers would also be disallowed as match unless they were general taxes on providers with no guarantee that revenues would flow back to the taxpayer.

State officials will fight implementation of the regulation. At the National Governors' Association meeting in August, Governor Clinton pushed other governors to increase their level of interest in bootstrap financing, which he characterized as a "very big deal." He pointed out that the federal action affects *this year's budgets*. He noted it could force options of raising taxes, cutting Medicaid, or cutting other programs to finance Medicaid.

Gambling: In its annual survey of gambling, *Gambling & Wagering Business* (8/15-9/14) finds the total amount legally bet in the U.S. in 1990 was $286 billion, over $1,000 per capita and over $2,500 for every employed American. The gross wager (handle) exceeds gambling losses and gambling establishment profits by wide margins because winnings are often recycled and thus counted many times.

The changes from 1989 reflect the continuing decline of on-track horse betting, which experienced a 1% decline in handle. State decisions to allow simulcasting of racing from other tracks and off-track betting gave the industry a 1.4% increase in gross revenues. The big gainers, from low starting points, were Indian reservation gambling (33%), legal bookmaking (17%), casinos (16%), and card rooms (11%). State lotteries gained 7.9%. The lottery sales results were uneven as shown in Table 4.

Table 4: Percentage Gain In Lottery Sales, 1989 to 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Minnesota	*	12	New Hampshire	12%	22	Missouri	1%
2	South Dakota	545%	13	Delaware	10	23	Iowa	0
3	Indiana	220	14	Connecticut	8	24	New Jersey	-1
4	Montana	100		**United States**	**8**	25	Arizona	-2
5	Virginia	74	15	Maryland	8	26	Washington	-2
6	Idaho	70	16	Rhode Island	8	27	Maine	-4
7	Colorado	62	17	Ohio	7	28	Kansas	-7
8	Wisconsin	42	18	New York	5	29	Pennsylvania	-7
9	West Virginia	27	19	Illinois	4	30	Oregon	-11
10	Vermont	18	20	Massachusetts	1	31	California	-12
11	Florida	15	21	Michigan	1	32	Kentucky	-18

* New lottery, first sales in 1990.

The striking gains were mostly scored by newer lotteries that account for a small percentage of total national sales. The larger and older lotteries, such as those of California and New York, didn't have such a good year. Part of the problem is recession, which tends to affect consumer purchases of about everything including lottery tickets.

Further gains in lottery sales nationally seem likely. Lottery states now account for about 75% of U.S. population. Two large states, Georgia and Texas, have scheduled lottery measures for statewide votes soon. Overwhelming approval is expected in both cases. Louisiana's lottery begins operation in September. Approval also seems likely soon in several other states. So lottery revenue gains will result from larger markets.

Revenue is also likely to gain from new games, specifically the video lottery terminals that account for much of South Dakota's spectacular gains in Table 4. Many states are considering adopting VLTs. In addition, **Reports** expects some states to increase gross revenues -- though perhaps not net revenue to state government -- by increasing the player's odds of winning. A player spending (losing) $10 on a lottery with 50% odds will generate gross revenue of about $20. With odds of 60% for the player the same $10 of player loss and state net revenue will generate gross revenue of about $25.

Gambling & Wagering Business expects a continuing growth in non-conventional legal gambling. Gambling casinos are opening on Indian reservations throughout the country, though the magazine is concerned that they may become "a back door for organized crime to re-enter the gaming industry." Special arrangements -- cruise ships, riverboats, and special Western gambling towns -- all appear to be drawing big crowds.

Health Plans: Probably the most ambitious state health plan adopted this year, excluding Hawaii, was Minnesota legislation providing coverage for about 35,000 residents starting next year. It was designed to expand in five years to cover all of the estimated 400,000 uninsured residents. Initial financing was from an increase in the cigarette tax. With full implementation, costs were estimated in the wide range of $300 million to $1 billion a year. Citing costs and alleged deficiencies in the plan, the governor vetoed it. Override is possible, but unlikely.

Oregon's plan for the prioritization of Medicaid services has all the state legislative approvals and funding Oregon health officials think they need. Next stop is the federal government for a waiver of Medicaid regulations which is needed by the end of the year so Oregon can start the plan on schedule next summer.

State Health Notes (July-August) reports the number of states with "basic benefit" private health plans reached 20 as a result of the 1990 legislative sessions. Although some are adopted with great fanfare, the substance of the laws is simply to exempt private plans from mandated coverages (e.g., mental health) previously required by state law. The laws also limit employers who may provide such plans using criteria such as small size or absence of a previous health plan. Some stipulate what services must be in a basic plan.

State And Local Finances, Light At The End Of The Tunnel: The latest Commerce Department estimates of the components of gross national product suggests state and local finances may be improving. Because of balanced budget requirements, revenues and spending shouldn't be showing large imbalances indefinitely. The results for the second quarter of 1991 show a deficit for all state and local governments combined of $34.7 billion, a substantial improvement from the deficits of $41 billion in the first quarter and $44.8 billion in the fourth quarter of last year.

States With No Budgets: In late August, only two states were without budgets. Connecticut continued the stalemate between a governor who insists on an income tax and a legislature that won't pass one. The governor has already vetoed three budgets financed by revenue measures other than an income tax. Michigan didn't have a budget, but wasn't overdue as its fiscal year starts in October.

As states operated without budgets or continuing resolutions, there were many differences in appropriations law interpretations. Connecticut paid for "essential," but not "non-essential" services, a distinction made nowhere else. Pennsylvania paid prisoners but not guards. Several states paid welfare recipients but not school districts or employees. Several governors asserted authority to continue government by executive order. Many of the decisions were of doubtful legality, but won't be the subject of final court decisions. Passage of appropriations results in payments to everyone and moots the pending cases.

Who holds the record for going without an enacted budget? No one knows. Perhaps it is a state disrupted by the Civil War. The modern state record seems to belong to Pennsylvania which enacted its budget in June of 1956, 11 months into the fiscal year. The runner-up is Ohio for enacting a budget in December of 1971. In both cases, as in Connecticut, the governor wanted an income tax and legislative majorities didn't. The tax was enacted in Ohio, but not in Pennsylvania until years later.

Vermont Leadership Passes: Vermont's Governor Richard Snelling died of a heart attack in mid-August. The last governor to die in office is believed to be New Hampshire's Governor Gallen in 1982. Snelling, a Republican, was a key to enactment of the comprehensive tax increases and budget balancing measures that passed the Vermont legislature earlier this year with considerably less acrimony than experienced in other states making similar fiscal adjustments.

Vermont, like some smaller states, doesn't have the governor and lieutenant governor run as a team. So the new governor, Howard Dean, is a Democrat. He will serve until inauguration of a new governor in January of 1993. The 1991 legislative actions were designed to put state finances on a sound footing for several years, so little legislative activity is expected in 1992.

Grant Reform And Federalism: Governor Snelling was in his fifth two-year term. His earlier terms spanned 1977 to 1985. During that period he was a national leader in the "sorting out" negotiations. They involved moving power and fiscal responsibility for some programs to state and local governments while increasing the federal role in income-tested programs.

The negotiations never produced agreement, but the policies contemplated have gradually been implemented. Federal emphasis, as measured by spending, has shifted from many smaller grant programs to income-tested programs (Food Stamps, AFDC, Medicaid, Compensatory Education). More money goes to state governments and less directly to local governments.

More proposals along these lines are being made, including proposals this spring by the President, NCSL, and NGA. Their history and substance are summarized by Bruce McDowell (Advisory

Commission on Intergovernmental Relations) in ACIR's Intergovernmental Perspective (Summer).

He gives Snelling credit for the proposal that most federal grants be eliminated in favor of equalization grants to the states. The plan would work much like school foundation aid programs of the states.

Another concept associated with Snelling (and others) resurfaced in the health care policy statement being considered by the nation's governors. Its central thrust is that the federal-state sharing of costs and responsibilities be sorted out. The federal government would assume responsibility for long-term care, primarily nursing home care of the elderly and institutional care of the severely retarded or disabled. This would reduce state Medicaid costs by about 40%. The states would be expected to use the freed resources for substantial attempts to expand availability of other health care.

TECHNICAL NOTES

Bootstrap Financing: For assessments of the risks and gains as well as the outlook for Medicaid bootstrap financing, see Issues 14 and 15.

Industrial Midwest: There isn't any rigorous definition of what states constitute this group. Its core is Illinois, Indiana, Iowa, Michigan, Minnesota, Ohio, and Wisconsin. Conceptually, the category would be neater if the substantial agricultural portions of these states could be excluded. Arguments can be made for including Upstate New York and Western Pennsylvania, and perhaps Missouri.

State And Local Finances: To present the data on deficits **Reports** had to estimate the corporate profits tax accruals, which constitute only about 2.5% of total revenues. The data, which appear in the Survey Of Current Business (dated July and issued in mid-August) typically show some deficit for complex reasons related to how national income accounts are kept. Basically, when the new borrowing of state and local governments for long-term capital outlay exceeds repayments, a deficit will appear. The deficits don't include pension funds, which run at a surplus of about $70 billion a year.

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September 1991 (First of Two Sept. Issues)

ASSESSING BUDGET PROCEDURES

Introduction: Legislators, lobbyists, and media observers had many reasons to be dissatisfied with state budget procedures this year -- more than in most years. The major problem was that they produced situations apparently requiring votes for tax increases and/or spending cuts. They also led an unusually large number of states to miss their deadlines for budget enactment. In many cases, bills were voted upon by members who admitted they hadn't read them because there wasn't time. As a result, there are many reappraisals built around the concept of doing better next year.

The Budget In The Legislature: Procedures in the legislatures themselves seem least likely to change. Rank and file members not on appropriations or revenue committees felt excluded from the process. Where circumstances permitted budget enactment without minority party votes, minority members and leaders felt excluded. Interest groups often felt left out of and uninformed about key last minute negotiations. Media personnel complained that compliance with open meetings laws was inadequate. These criticisms are persistent ones, but the reforms designed to deal with them often seem not to alter the results in the following legislative session.

Part of the problem is that rules changes don't always have the results intended. For example, Pennsylvania made changes back in the late 1970s to end the extensive floor debates with multiple amendments that had slowed the budget process. But with a budget not enacted until well after July 1 this year, there is some discussion of reverting to more open budget procedures. At the federal level, one purpose of moving the fiscal year to an October 1 start date was to enable the Congress to have time to enact a budget before the beginning of the year, which hasn't worked well. In Illinois, the plan to avoid partisan deadlock on reapportionment was to have a critical member of a reapportionment panel decided by lot if legislators couldn't agree. The result wasn't agreement, but decision by chance.

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There were a few new procedural twists this year. The Texas legislature, acting in special session, managed to move its complex revenue legislation and a biennial budget without conference committees. The House passed its bill. The House-Senate negotiations then took place before the Senate passed its version. Then the compromise measure was passed in the Senate and accepted by the House. In Ohio, and probably in other states, some key tax proposals appeared as a conference committee result without having been in either the House or Senate bill. The chairman of the conference committee told an audience of private detectives that the tax measures were handed to the conference committee members three hours before the scheduled committee vote. The list, assembled by legislative leaders and the executive budget office, included applying the sales tax to detective services. The chairman told the statewide organization of detectives that he apologized for the manner in which it was done and noted they didn't have any time to try to stop the tax proposal.

Vetoes Of Budget Provisions: Also unlikely to be changed, because the powers are in state constitutions, are the roles of executive vetoes in the budget process. In most states most of the time, the veto power is rarely used on major parts of budget legislation, though governors with item veto powers use them to eliminate particular projects. There were some extensive uses of the veto this year. The one with the most impact was in Connecticut, where the governor's veto of three measures without income taxes led to enactment of a new income tax. In Minnesota and Wisconsin, governors restructured budgets with significantly higher spending and tax increases to austere budgets with no major tax increases. The Wisconsin restructuring involved 457 separate veto actions. In Alabama, where the fiscal year doesn't start until October, the governor has vetoed the entire budget.

The Omnibus Budget Bill Or Separate Bills? Another continuing budget process debate concerns how comprehensive the budget bill should be. One school of thought is that the bill (or perhaps several bills linked politically, if not legally, and passed simultaneously) should cover everything essential to the budget. This includes appropriations, taxes, other revenue measures such as fee changes, and laws clearly affecting spending such as health care provider reimbursement rates, welfare payment levels, and employee pay. This view keeps all legislation affecting spending and revenues consistent. But it moves many issues out of subject matter committees and into the finance committees, produces 1,000+ page bills that members don't have time to read, and leaves many legislators with the feeling they are excluded from major policymaking.

The alternative view is to keep substantive legislation out of appropriations bills. This solves some of the problems of the single bill, but presents the problem of inconsistent provisions. Another problem arose in Connecticut in September. With considerable agony, the legislature passed its controversial budget in August including a new income tax and various fee increases. While the fee increases were in the financial totals on which the budget was based, they weren't in the bill that passed by the narrowest of margins. So there was what some states call a "trailer bill" to be passed in September. In Connecticut, the measures are called "budget implementation bills." They are normally approved automatically, but not this year.

When time came to approve the trailer bill, the votes weren't there as legislators who voted for the budget and tax increases wouldn't go on record to increase costs of drivers' licenses, car registrations and other items. So fee increases of $44 million were dropped and the loss partly balanced by eliminating $31 million from aid for local roads. Another $32 million in fee increases didn't pass either, with no corresponding spending adjustment.

Revenue Estimates: Revenue estimates for FY 1991 were wrong in most of the states by wide margins. The consequences of the errors were serious -- mid-year budget cutbacks, tax increases, depleted reserves, freezes on promotions and hiring, etc. One obvious response is to blame the revenue estimators or the revenue estimating process. Very little of this seems to be occurring.

There are several reasons for the errors in revenue estimates. First, the projection methodology of many states is quite sophisticated, with assumptions disclosed and economic models documented. For the key assumption of national economic performance, state forecasters tended to use highly defensible (though not necessarily correct) estimates such as consensus forecasts or forecasts of one of the major econometric firms. Such estimates were close to each other and close to the estimates being used by the federal government. With explicit methodologies published when estimates were made, many state estimators have been able to demonstrate that a misestimate of national numbers -- specifically not predicting a recession -- was the source of most of their error.

A second reason is that many states use consensus revenue estimating techniques, where multiple players like legislative staff, executive budget office, and sometimes private forecasters from banks and universities agree on estimates. In other states, such as California and Illinois, separate estimating groups made about the same FY 1991 estimates and thus made the same error.

When state officials make the same mistakes about the national economy that everyone else makes and when those mistakes are made by many different state estimators, it is hard to fault the estimating process. So much of the concern, as typified by South Carolina, boils down to issues of when during early 1991 the revenue estimators should have recognized the downturn. The exceptions are the few states in which partisan arguments developed over revenue estimates preceding the November 1990 elections with critics -- Democrats in Maine and Republicans in New Hampshire -- contending that the revenue estimates were overly optimistic even without assuming recession.

While the conclusion that the revenue estimating process may not be fixable appears widespread, there are any number of assessments taking place within revenue estimating agencies and by outside groups.

Saving Money: If it were ever possible to tabulate the results of the legislative sessions, the reckoning would show that little government spending in FY 1991 was eliminated in FY 1992. Much of what was offered as savings were simply making smaller increases than inflation, shifting costs to future years, and shifting costs to other payors such as university students and local taxpayers. In retrospect, the prevailing view was that expressed by Governor McKernan in a post-session interview with the Maine Telegram (8/4):

> The important thing to understand is that most of the extra costs are policy differences. How lucrative should our state retirement system be? How generous should we be in welfare payments? How much should we have for annual increases in our health insurance plans? That's where the money is.

Nonetheless, new studies aimed at stemming rising spending appeared with the budget and tax measures. For example, the Connecticut package creates the Commission to Implement Government Reorganization. It also provides for a tax review commission to examine the state's tax structure, which was sharply changed by adding a personal income tax this year. In Ohio, there is the Operations Improvement Task Force, whose chairman is talking about recommendations that could cut state operating costs 5-10%. The group's costs, an estimated $500,000, are being covered by business donations. Maryland's governor has announced he will appoint a similar panel. In Iowa, the comparable group is the Governor's Committee on State Spending.

Spending Estimates And Binding Appropriations: Those who consider budgets a binding blueprint for spending will find statistics in NCSL's preliminary report on budget actions shocking. The report indicates that post-budget actions in FY 1991 worked a major reorganization of spending priorities to benefit corrections and Medicaid at the expense of education. The changes are shown in Table 1.

Table 1: Budgeted And Actual FY 1991 Spending Increases
Percentage Increase Over FY 1990 Actual Spending

	Approved In Regular Budget	Subsequent Adjustments	Final Increase
Public Schools	7.9%	-4.9%	3.0%
Higher Education	5.8	-6.7	-0.9
Corrections	12.5	5.1	17.6
Medicaid	15.9	6.6	22.5

NCSL comments in the survey report that the same phenomenon is likely to appear when the FY 1992 results are tallied, with Medicaid and corrections again outpacing appropriated amounts.

Revising The Texas Budget: Governor Richards signed the new Texas budget just before the September 1 beginning of the fiscal year. While approving it, she called for unspecified "truth in budgeting" reforms to be enacted when the next budget is considered. Her concerns: "If the average Texan wanted to see how much money Texas spends, they would need a lawyer, an economist, and a computer programmer to find the true bottom line ... Our budget is a maze of special funds and transfers, and spending that does not show up in line items, but instead is hidden in special riders."

HEALTH CARE FINANCING

Introduction: Health care continues to draw attention in state government because of its overriding fiscal significance as well as its importance to state citizens. On the revenue side, potential federal disallowal of bootstrap financing is nearly as much a risk to state finances as a national economy that fails to recover from recession as predicted. Medicaid, employee health care, and other health spending account for the bulk of spending growth in many state budgets and will probably account for most of the overspending of appropriations in FY 1992.

The level of frustration over health care at the summer National Governors' Association meeting was high. The reasons are clear when stated starkly. Medicaid costs are likely to rise at double digit rates. The likelihood of federal solutions is low. The possibility of federal withdrawal of reimbursements in bootstrap financing situations is high. Little money is available for prevention programs. Efforts to make health insurance more widely available have inherent problems, as they generally involve reducing coverages previously mandated by states. The number of Medicaid recipients has been growing. While the data aren't in yet, the percentage of people covered by private insurance has probably been shrinking.

Governor Gardner (WA), who chaired the conference, commented, "In my seven years in this association, I have never seen this intensity on an issue before." The governors' resolution called Medicaid "broken." Many governors expressed concern over the high costs of health care relative to other countries and over deficiencies in health care availability. Much of the governors' debate concerned how fast they should urge health care improvements leading to some form of universal care, not whether they should urge the improvements.

Bootstrap Financing Of Medicaid: State concern over potential federal regulations disallowing provider donations and taxes as Medicaid match has been mounting as more state officials recognize the consequences of losing the money. At the governors' meeting, Governor Edgar (IL) warned that the regulations could be disastrous. If promulgated, he predicted that in Illinois "we will see hospitals and nursing homes close."

While some governors and others are warning about impacts, the consequences of major regulatory change in bootstrap financing aren't well understood. For the significantly affected states, changes in the bootstrap financing rules will have the effects in FY 1992 and FY 1993 that unanticipated recession and unanticipated soaring Medicaid costs had in FY 1991 and FY 1992. Many states responded to diminished revenues and higher health costs by continuing health programs and cutting other programs and/or raising taxes. ***Just as public schools, state universities, local aid, and various social programs felt adverse consequences from recession-related revenue losses in 1991, they may well suffer similar consequences from Medicaid-related revenue losses in 1992.***

In mid-September, the U.S. Department of Health and Human Services announced its regulations barring bootstrap financing. It estimated that 37 states would be affected on January first when the regulations take effect. OMB estimated that about $3 billion is involved in federal FY 1991, which will not be affected. The total mounts to $5 billion in federal money in FY 1992, three fourths of which will be affected because reimbursements will occur for three fourths of the federal fiscal year. Viewed on a state basis, the reimbursement loss is probably on the order of $2.5-3.5 billion in the current fiscal year and at least $6 billion in FY 1993.

This is big money for all affected states. One option will be cutting back Medicaid reimbursements or coverage. A few states, such as Indiana, tried to leave themselves in a position to do this, which may or may not work. Others will find the reimbursement loss comparable to the same size loss of revenues from any source. They may attempt to cut back Medicaid, but will encounter the same difficulties as they did in considering balancing their FY 1992 budgets. They may consider cutting back other programs, but many will have to revisit the issue of tax increases. This will be especially likely in states which already have budgets that are tenuously balanced, or not balanced. Examples are Alabama, Illinois, Maryland, Minnesota, New Hampshire, Pennsylvania, and Tennessee.

States are expected to sue quickly. Prospects for final success in this litigation aren't particularly good. The HHS regulations don't go into effect until January 1 because Congress enacted a prohibition against them that ends on that date. The existence of the prohibition implies that without it HHS does have authority to issue the regulations. But even if it failed in the long run, litigation could succeed if it resulted in a delay in the effective date of the regulations. This would save reimbursements for the duration of the delay and pave the way for the second approach.

That approach is obtaining from Congress a renewal of the prohibition against regulations of the type HHS wants to issue. That approach offers somewhat better prospects. The states have several things going for them. First, there is a strong case that inaction by the Congress will cause tax increases in many states. Second, as a practical matter, Members of Congress wanting to expand federal health care spending will have few other options. Third, given the way the Congressional budget procedures work, a vote for the prohibition doesn't appear as federal budget-busting.

Medicaid Cost Escalation: Even without problems in reimbursement, Medicaid will be taking a bite out of other programs in FY 1992. According to NCSL's preliminary survey, state revenues will rise a little over 8% and Medicaid will rise by a budgeted 12% plus a predicted large but unquantified overrun requiring supplemental appropriations. If Medicaid, a large portion of total spending, is to rise at a faster rate than revenues, then other programs must rise at a slower rate.

Some of this year's Medicaid cost overruns were being conceded almost before the ink on the new budgets was dry. For example, Maryland executive branch officials were talking about a $60 million overrun, about 6% of the Medicaid budget, in August. The governor is talking about trying to hold down costs by encouraging more preventative measures such as prenatal care, immunizations, and regular tests like mammograms and Pap smears.

Besides threatening other programs, such as education, double-digit cost escalation in Medicaid reduces the funding prospects for changes in Medicaid itself. The casualties include: (1) expanding services to additional populations by lifting eligibility thresholds, (2) providing optional services (e.g., eyeglasses) in states where they are not covered, (3) experimenting with programs such as preventive health and home health care, and (4) increasing provider reimbursement rates.

A recent General Accounting Office report reflects this conclusion in its title, Medicaid Expansions: Coverage Improves But State Fiscal Problems Jeopardize Continued Progress. The report concludes that to finance recent Medicaid expansions, "some states reduced or eliminated funding for public clinics, or cut back portions of their Medicaid programs by such actions as limiting enrollments or discontinuing optional services." GAO notes, "Given the fiscal problems of many states, reliance on such fund-shifting approaches may become more widespread."

Studies: During the late 1980s, many states appointed blue ribbon task forces to develop and recommend health care solutions. These were intended to deal with broader problems than just Medicaid, particularly the large percentage of the population lacking health insurance. Many of these, such as Pennsylvania's, simply petered out with no recommendations that were taken seriously in the legislative process. Others, such as Maine's, resulted in some demonstration programs but no major changes in the state's health care delivery system. With new governors facing the problem, there will probably be some new commissions. For example, Governor Richards has announced she will appoint a "Texas Health Policy Task Force." It will have a broad charter including making basic health care available and affordable to all Texans.

Employee Health Care: Health care costs of state employees remain a difficult issue for states and employee groups alike. Because health care benefits provided by employers are free of federal and state income taxes, employer-provided benefits are clearly preferable to having employees pay for health care with after-tax dollars. But this isn't true if the fact of employer payment causes employees to pay more and/or consume more health care services. Concern about this aspect argues for some employee participation in cost. In addition, there is inherently a tradeoff between dollars spent on greater or more costly benefits and for higher wages. In some tight budget situations, there is also a tradeoff between money spent on increased wages and benefits and layoffs, with state administrations arguing that concessions on benefits and wages are necessary to minimize layoffs. These issues have been present in every state. California and New Jersey provide examples of labor-management conflict, while Connecticut provides an example of smoother relations, at least for a time.

A recent study by the State and Local Government Labor-Management Committee indicates that cost-containment actions taken through labor-management cooperation have been more effective in the public sector than those decided by management alone. The management plans are more likely to take costs as a given and shift some of them to employees by higher copayments and deductibles and higher premiums to be paid by employees. The joint plans are more likely to stress wellness programs and reducing costs by controlling utilization and/or cost of services. The Committee, which consists of representatives of labor and organizations like NCSL and NGA, cites two local government success stories and one from the Minnesota state government.

Both California and Massachusetts left major employee health care issues for resolution after the budgets were passed. In California, the governor is engaged in negotiations with employee unions that have made little progress. In Massachusetts, the governor sought to control spending on the state employee plan through a budget item veto, but it was overridden. This has thwarted attempts to increase the portion of health care costs paid by employees. This leaves the possibility of reducing the cost (and thus value) of the state health plan by reducing benefits, an avenue the governor has indicated he will pursue.

ECONOMIC DEVELOPMENT INCENTIVES

The Economic Development Priority: State and business officials often ask **Reports** and others questions about state economic development priorities: Are states doing more? Are they spending more? Does one state do more or less than others in the region?

The questions aren't answerable without a major research project. It is relatively easy to tabulate what states spend through money appropriated to economic development agencies and hard, but possible, to develop a comparable figure for the larger number of local agencies. But this is just a fraction of what is spent in the name of development. Bigger numbers are elsewhere. In state budgets are spending for developmentally oriented highways and parks, for higher education extension-type programs, and for job training -- not to mention the overall costs of a high quality education system. Outside state budgets are the costs of state and local tax concessions and the very large concessions sometimes approved in state-regulated electric and gas rates and local water and sewer rates and terms of service. These costs aren't calculated and summed in individual states and thus can't be compared across states.

Measuring words, not deeds, isn't a satisfactory substitute, although a recent study suggests economic development has shown a consistent increase in importance as measured by a content analysis of governors' messages. The results appear in Table 2.

Table 2: Ranking of Gubernatorial Policy Priorities, Selected Years

Policy Area	1971-72	1979-80	1989-90
Elementary and Sec. Education	1	1	2
Law Enforcement/Corrections	2	8	7
Higher Education	3	12	5
Health	4	14	8
Environment/Natural Res.	5	10	3
Welfare/Social Services	6	3	4
Transportation	10	6	9
Economic Development	12	2	1

Economic Development And Taxes: There will never be agreement on how much impact the state tax increases of 1991 had on economic development relative to states that didn't raise taxes or raised different taxes. Most of the increases probably won't have any discernable effect. The increases were small or were concentrated on the sales tax to which business location isn't considered particularly sensitive except for cross-border sales. The more interesting changes are concentrated in a few states.

Pennsylvania's increase in the corporate income tax rate to 12.25% reverses prior actions to lower the rate and gives the state a double-digit rate well above competitor states. New Jersey officials quickly held a press conference to appeal to Pennsylvania firms to consider New Jersey with its lower corporate rate. Pennsylvania's acting commerce secretary complained of "border skirmishes" and argued that the two states should cooperate in economic development. USX had threatened to pull out of Pennsylvania if the manufacturers' exemption in the franchise tax were repealed. It wasn't, but a company spokesman indicates that "Pennsylvania has the highest business taxes of any of our competing states." Hershey Foods called the new corporate income tax rate "dramatically higher than virtually any other state's and will have a significant negative impact on business growth and development in Pennsylvania."

California's increase in the top bracket personal income tax will add slightly to arguments from competitors, but many, particularly Nevada, already had significantly lower taxes. The changes in Massachusetts and Connecticut are large, but their effects on development aren't clear. Connecticut lowered the corporate rate and the rate on personal interest and dividends while taxing earned income for the first time. Massachusetts repealed its sales tax on services, but has put considerable pressure on local property taxes and other revenue sources.

While tax increases have gotten most of the attention this year, there is a continuing flow of tax reductions for business. An interesting one was adopted in Louisiana. It applies to medical and biotechnology research districts, of which there will be three. The districts, like enterprise zones, will offer tax breaks to firms locating there. The Louisiana statute seems to provide comprehensive exemption from property, sales, income, and franchise taxes.

Economic Development Loans: New Mexico is folding its New Mexico Business Development Corporation. The business plan of the early 1980s, like that of some other states, was to create a private corporation to make loans in the niche created because some small businesses with good potential couldn't get loans from banks. The corporation was financed by equity purchased by the private sector (with some state inducements) and a loan from the state. Critics, particularly in retrospect, have suggested the niche doesn't exist. Equity holders have lost their stake, but the state may get much of its loan back.

California Development: California's losses of businesses to other states have recently been assessed by both the Washington Post (9/1) and New York Times (8/12). Trouble is indicated by a California Chamber of Commerce study, a Business Roundtable survey indicating many businesss are considering relocation, and by specific examples of firms that have moved or are considering a move. Reasons include high costs of housing, labor, and health care, concern over educational quality, long trips to work, Workers Compensation costs, complexity and substantive restrictions of environmental protection laws, and high corporate and personal income taxes. The prime beneficiaries of corporate moves appear to be Arizona, Nevada, and Utah.

The subject is of little concern to some Californians who see the state's continuing growth as a cause of even higher living costs, more congestion, and environmental damage. But others are concerned. The state Chamber of Commerce has a new Task Force on Saving California Jobs. The state development agency is developing an early warning system to detect and prevent possible moves. Development concerns played a role in the governor's decision to press for Workers' Compensation reforms, even at the expense of delaying enactment of the FY 1992 budget.

FEDERALISM, US AND USSR

Federalism In The USSR: State-oriented observers in the U.S. with a sense of history have probably recognized the close association between the debates now taking place in the USSR and the debates in the US between the end of the Revolutionary War and the adoption of the Constitution. The arrangements now being discussed in the USSR closely resemble the Articles of Confederation in the US. The national government is given power over external defense and foreign relations and little else. The leaders of the national government are selected by the states/republics, not by national elections.

The early American issues are the same ones likely to be faced in the USSR. Can individual states/republics opt out of the arrangement, as American states tried to do in the Civil War? Can individual states/republics erect barriers to imports from other states, still an issue with garbage in the US? Can the national government collect taxes directly or must it rely on contributions from the states/republics?

Federalism, Truck Taxes: It has long been established that the Constitutional protection of commerce among the states precludes one state from barring sellers from another state from marketing their goods. There are also cases establishing the principle that a state cannot use its tax system to tax out-of-state goods or services more than those produced locally. Cases involving this principle are still active.

For example in August the Pennsylvania Supreme Court implemented a 1987 U.S. Supreme Court case (America Trucking Associations v. Scheiner) invalidating the state's "flat" axle tax. The case, which involves $50 million in refunds to truckers, has parallels in about a dozen states. The state levied a per-axle tax of $36 which, truckers successfully argued, was more of a burden on out-of-state truckers using Pennsylvania highways rarely than on in-state truckers using them all the time.

Federalism, New Hampshire Taxes: New Hampshire has maintained its status as the only state without a sales or income tax despite a close vote on an income tax this year. One way to pursue this policy is finding ways to tax residents of other states. To this end, the state has steep hotel and motel taxes and maintains cigarette taxes and liquor mark-ups to draw business from other states. Local tracks are positioned near the borders of other states. This year it levied a special property tax on nuclear generating plants. There is only one in the state. It sells primarily to other states. The new law has what amounts to a rebate provision for the New Hampshire utilities. Neighboring New England states are suing to block implementation.

New Hampshire could lose the case, which originates in the U.S. Supreme Court under the special arrangements for one state suing another. This wouldn't be the first loss of an interstate tax discrimination case. The Granite State lost an attempt in the 1970s to impose an income tax on out-of-state commuters without taxing its own residents. In the 1980s, it lost an attempt to collect more from out-of-state residents for hydroelectric power generated within its borders.

Federalism, Alabama: A major issue in Alabama is what could be considered an import duty. Previous court decisions establish that waste products are goods moving in interstate commerce under protection of the U.S. Constitution. Alabama is charging $40 a ton for hazardous waste disposal, plus $72 a ton if the waste originates outside the state. The state supreme court has upheld the differential. Chemical Waste Management, Inc., which operates the largest facility in Alabama, has indicated it will appeal to the U.S. Supreme Court.

Federalism, New York Taxes: Pennsylvania's governor recently decided to join a tax case brought by New Jersey and Pennsylvania residents over New York's tax policy. Before 1987, New York applied its graduated income tax to non-residents working in New York, calculating tax liability based on the income earned in New York. In 1987, it changed policy to use all income in considering the appropriate tax rate for the New York income. As a result, a non-resident worker will pay a higher New York tax if he or she has a spouse working in their home state or has a part time job in the home state besides the New York job. There is also legislation pending in the Congress seeking to outlaw the practice.

STATE AND LOCAL FINANCES

Fiscal Policies Of The States: With Georgia's revenues falling well below expectations this summer, state estimators have been predicting a shortfall of $400-500 million in the enacted FY 1992 budget. Governor Miller responded by calling a special legislative session and recommending spending cutbacks -- recommendations accepted by the legislature with little change. A few legislators and many groups interested in spending wanted a tax increase. The governor argued, "Of all the times you don't want a tax increase, it's during a recession." He argued that such an increase would dampen consumer spending. California's Governor Wilson expressed a similar view early this year, "If you speak to any economist ... they will tell you that a recession is the worst time to impose new taxes."

These governors were reflecting classic Keynesian thinking about government fiscal policies. It holds that in recession, government should put purchasing power into the economy by spending increases and/or tax cuts. Conversely, in boom times, government should take purchasing power out of the economy by spending restraint and even tax increases. Such policies aren't easily pursued by state and local governments with balanced budget requirements.

A few states have been trying to accelerate spending outside the general fund through public works construction financed by bond issues and/or federal funds. Governor Dukakis announced a major program along these lines for Massachusetts, but his successor, Governor Weld, hasn't been stressing the issue. There are some massive job-creating projects in process -- particularly the Boston harbor tunnel and clean up of Boston Harbor -- but construction depends upon environmental clearances and federal approval. The new governor has announced strict limits on the total borrowing each year, because of concerns with bond ratings and future debt service costs. A similar program from Governor Florio in New Jersey is highly dependent on bond issues, one of which was rejected by voters last year.

In Rhode Island, Governor Sundlun has been pushing pump-priming by projects like a convention center in Providence and an airport in Warwick. He is also trying to accelerate highway construction.

In their general funds, however, states are pursuing their classic policies of taxing more and spending less to try to bring budgets into balance. According to the NCSL preliminary fiscal survey, state budgets call for a growth of 8.3% in general fund revenue but only a 4.2% growth in spending. Viewed another way, the survey results indicate that the 45 states responding pumped $4.2 billion into the economy in FY 1991. This was a result of the inadvertent imbalance of budgets which drained reserves by that amount. But, if budget projections hold, in FY 1992 the states will draw $1.6 billion out of the economy to replenish reserves.

Fiscal Update: In special session in August, the Texas legislature adopted its biennial budget including many of the management and cost-cutting measures recommended by the comptroller's report described in Issue 17. The major tax increases are a five-cent gas tax hike and a revision in the base of the corporate franchise tax making it resemble the corporate income taxes of many states.

Texas may well have the largest percentage of its budget under judicial control of any state -- prisons, school finance, mental health, mental retardation, etc. State leaders have resolved to end this situation. Recently progress was made when the state defeated property-rich school districts in a state trial court over the new school finance plan. A settlement of 17-year old litigation on mental retardation programs was also announced.

Connecticut extended the stalemate between a governor who insists on an income tax and a legislature that wouldn't pass one well into August. The governor vetoed three budgets financed by revenue measures other than an income tax. The legislature then adopted a comprehensive measure featuring a 4.5% income tax. Besides closing the state budget gap, the tax will finance reductions in the sales and corporate income tax rates and reduce the taxes on dividends and interest.

Michigan leaders have indicated agreement on a no-new tax budget, though it may not be balanced. The state's fiscal year starts in October.

Temporary Taxes: This has been a big year for the enactment of "temporary" tax increases. The best example is California, where a portion of the sales tax increase is temporary.

It is easy to be skeptical of "temporary" increases. As Georgia's Governor Miller recently commented in rejecting a proposal for a temporary tax increase to deal with the state's temporary revenue shortfall, "I don't think there is any such thing as a tax that is temporary. That is like being half-pregnant." State Budget & Tax News ignores temporary taxes in its tabulations of state tax increases, so extending a temporary tax isn't considered a tax increase. Some years ago, Louisiana legislators were unable to reach agreement on a tax reform plan so they enacted a tax few of them liked -- temporarily extending the sales tax to food and utilities. This solved the state's fiscal problem, but a new problem appeared each year as scheduled phase-out of the measure created large holes in the state's budget. The tax has been renewed each year.

Another version of the temporary tax is the scheduled phase-down of tax rates. In many cases, these didn't take place this year. New York's personal income tax was scheduled to be reduced, but was slightly increased instead. Texas taxes on business property were scheduled to be reduced, but the effective date was postponed in the recent special session. The temporary label on the 1989 income tax increase in Illinois was taken seriously in the 1990 gubernatorial campaign. Governor Edgar urged that it be extended, as it was after extensive debate in the legislative session this year.

In Massachusetts, the income tax increases of 1989 and 1990 have produced a rate of 6.25%, which is scheduled to drop to 5.95%

at the end of this year. Given the state's budget cutbacks, some legislators want to continue the current rate. The governor's position is that "preventing a tax from dropping is the same as enacting a new tax."

Government Investments: In a recently released 101-page study, the Congressional Budget Office examines the economic rationales for higher government spending on physical infrastructure (e.g., highways and sewers), human capital (e.g., education and training), and on research and development. The report is lukewarm on infrastructure investments: "Although further, carefully selected investments in public infrastructure may well be productive, there is little evidence to suggest that substantial across-the-board increases in current programs would be more productive on average than private investment." Job training programs are seen as producing "modest gains" in the earnings of participants, but other human resource programs are seen as promoting non-economic goals. A few R&D programs get high marks, but most federally funded R&D is judged to expand productivity less effectively than privately funded R&D.

Government And Private Debt: American debt is so large that to pay it off would require about 23 months of devoting all the nation's production of goods and services to paying creditors. But state and local government debt isn't a major factor according to statistics compiled by the Tax Foundation in its August Tax Features. The amounts are shown in Table 3. State and local governments account for only 6.1% of the gigantic total.

Table 3: Debt Outstanding In 1991

Class Of Debtor	Amount (bil.)	Per Capita	Pct. of Total
Federal Government	$2,625	$10,432	24.7%
State and Local Govts.	649	2,[illegible]78	6.1
Households	3,860	15,3[illegible]	36.3
Non-Financial Business	3,503	13,924	32.9
TOTAL	$10,637	$42,277	100.0%

Debt burdens have been growing rapidly in nominal terms and growing substantially when related to gross national product. But in relation to GNP, state and local debt has dropped since 1970 as shown in Table 4. One way of viewing the trend is that from 1980 to 1991 debt mounted by 48% of GNP. Of this 48%, state and local governments produced only 2%.

Table 4: Debt Outstanding As Percent of GNP

Class Of Debtor	1970	1980	1991
Federal Government	30%	27%	47%
State and Local Govts.	15	10	12
Households	46	52	70
Non-Financial Business	49	53	63
TOTAL	140%	143%	191%

Local Finances: Chelsea, a small Massachusetts community near Boston, has been making public finance history disproportionate to its 25,000 population. It contracted out the operation of its school system to Boston University several years ago. Now it will be taken into a state financial receivership to run through 1993. Elected officials, who become advisors to a state receiver under the plan, have been unable to make ends meet. The community has high costs associated with having the highest percentage of residents below the poverty line in the Bay State and special education status for a percentage of students three times the state average. Voters have rejected attempts to raise property taxes. The community was also impacted by the local aid reductions used to balance the state's budget. The receivership doesn't entail additional state aid nor waiver of the state's limits on unvoted property taxes.

KUDOS

Introduction: There has been unusual attention directed at state leaders in the past several months, for reasons **Reports** doesn't pretend to understand. The attention is over and above the attention accorded governors who are considered possible Presidential candidates. This article provides some samples of what is being said.

Health Care: States are commended as the "real innovators" in health care by U.S. News (8/26). The magazine cites Hawaii's mandate of employer health insurance and universal care approaches, but notes that money and federal labor law present barriers to adoption in other states. Oregon gets credit for "the nation's first rationing scheme," but the article notes it still requires federal approval. Arizona gets credit for waiting longer than other states to participate in Medicaid, so "if Medicaid were to be reinvented today, it would look a lot like Arizona's program." The key is managed care, which many states are adopting.

Health Care And Education, Oregon: According to the New York Times (8/22), "Oregon is basking in national attention for its novel approaches to education and health care, both of which survived the budget axe." The aspect of health care mentioned is the plan to have some form of universal care by 1995. The education plan, passed but not implemented, involves many changes including requiring students to chose by the 10th grade whether they are on a college or vocational track. There is also new family leave legislation. The state is headed for a major fiscal problem. An initiative approved last fall gradually reduces property tax support of schools. The state is expected to fill the financial gap. To do so, most observers believe it will need to enact a sales tax, a solution voters have repeatedly rejected at the polls. The governor will be touring the state testing public opinion before making a proposal.

Performance Of New Governors: The 18 new governors elected in 1990 are reviewed by USA Today (9/10) and given thumbs up or thumbs down ratings by five experts with backgrounds in politics (as distinct from the substance of policy). The results are listed in Table 5.

Table 5: Ratings Of New Governors By USA Today Panel

Thumbs Up		Thumbs Down	
Governor	State	Governor	State
Symington	Arizona	Hickel	Alaska
Chiles	Florida	Carlson	Minnesota
Nelson	Nebraska	Walters	Oklahoma
Roberts	Oregon	Finney	Kansas
Wilson	California	Weicker	Connecticut
Miller	Georgia		
Weld	Massachusetts		
King	New Mexico		
Sundlum	Rhode Island		
Edgar	Illinois		
Engler	Michigan		
Voinovich	Ohio		
Richards	Texas		

The raters give special credit to Governors Richards and Wilson who both "saw their political stock soar after deftly dealing with huge budget deficits." Governor Wilson is featured by Governing (Sept.) for rediscovering "his competitiveness" and moving "back toward the bipartisan centrist approach that marked his early days in Sacramento a quarter-century ago."

Welfare Reform In New Jersey And Wisconsin: New Jersey House Majority Leader Wayne Bryant gets national attention (New York Times, 9/4) as "one among an emerging coterie of black Democratic leaders who question the effectiveness of social programs championed by the party's traditional leadership." He is credited for his own economic progress as part owner of a major new office building and partner in a major law firm. He is also credited with his progress in the legislative leadership and predicted to become speaker (or minority leader as the case may be) when the present speaker steps down. He has a controversial welfare reform package oriented to work incentives. The most widely cited (and opposed) portion would deny any increase in benefits for additional children born while the mother is on welfare. Another portion would provide strong, but expensive, incentives by reducing or eliminating the welfare eligibility cut off that now occurs from marriage or from taking relatively low paying jobs.

Welfare reform in Wisconsin got national attention when Governor Thompson used his veto power to create "Bridefare." By extensive changes in language of the budget bill, which are legal in Wisconsin, he resurrected a proposal, rejected by the legislature, to deny additional benefits to teenage welfare recipients because they have additional children. A federal waiver will be required for implementation. Wisconsin also has "Learnfare," which penalizes AFDC families whose children skip school, and "Workfare," which requires certain recipients to seek work to keep benefits. Bridefare also includes an increase in benefits if a teen mother marries the father of her child.

Calling him "Governor Toughlove," City & State (8/26) selected Thompson as one of its seven most valuable public officials. Time (8/19) featured him as offering "an imaginative -- but controversial -- solution to the problems of poverty and welfare dependency." George Embrey (Columbus Dispatch, 8/28) also featured Thompson's achievements.

Vetoes In Wisconsin: There is no scorekeeper, but Thompson probably also holds the record among governors for vetoes, about 1,500. One of his nicknames is "Dr. No." The special Wisconsin rules on vetoes are assessed in State Governments (August) along with unsuccessful attempts to restrict the powers.

State Government Management: Arkansas's quality management program in general, and Governor Clinton's management leadership in particular, get rave reviews from Fortune (9/5). Also mentioned: Minnesota's Governor Carlson for stemming the tax and spending increase trend and giving more emphasis to quality management. Governor Schaefer gets high marks from Time (8/16) for his annual exercise of having top Maryland officials swap jobs to gain experience and perspective.

State Think Tanks: Think tanks with a free enterprise orientation are the subject of a feature, "Hidden Persuaders," in Forbes (9/16). These are state-level operations similar to the Heritage Foundation nationally. The examples given are: (1) Yankee Institute for Public Policy Studies in Connecticut, (2) Commonwealth Foundation for Public Policy Alternatives in Pennsylvania, (3) the Washington Institute for Policy Studies, (4) the Mackinac Center for Public Policy in Michigan, and (5) the Pioneer Institute for Public Policy Research in Massachusetts. In many of these states, election of a new more conservative governor in 1990 has given more prominence to both the ideas and the personnel of the think tanks. In broad terms, the development of the phenomenon of public policy think tanks in individual states shows that the shift of power to the state level has been widely recognized.

Utah Development: Utah's economic successes are noted by the New York Times (8/25). The state gets credit/blame for high education levels, despite low per-pupil spending, a low average wage, a right-to-work law, moderate tax rates, and "the hard-work ethic of its large, young labor pool."

Environmental Protection: The Center for Policy Alternatives has recognized state policies as "best bets" in the field of environmental protection. Winners were energy conservation laws in Connecticut and Iowa, reducing use of tax-exempt bonds by industries that pollute in Louisiana, permitting cloth diapers in day-care centers in Maine, solid waste legislation in Missouri, New Mexico, and Wisconsin, forestry in Missouri, clean water legislation in New Jersey, and attorneys general of many states for their action challenging "green ads" by which companies make more environmental claims for products or packages than can be sustained.

Reverse Kudos: Rhode Island has been getting national publicity as citizens demonstrate over the continuing crisis of the state's credit unions. When the governor closed locally insured and chartered institutions early this year, about a third of the state's citizens had their deposits frozen. Since then, aided by the state putting up bailout money, most depositors have unrestricted access to their deposits, but not everyone. Besides organizations oriented to particular issues, like Citizens for Depositors' Rights, examples of apparent corruption in state and local politics have produced widespread voter discontent with incumbents. One citizen movement, named "Operation Clean Sweep," is attempting to unseat state incumbents regardless of party affiliation.

Governor Engler gets mixed reviews from USA Today (9/13). Budget cuts and a no-new-tax posture give him a higher approval rating than his predecessor. But a serious recall effort is underway, primarily in reaction to the budget cutbacks. The no-new-tax posture may not survive, as Michigan has yet to deal with a significant budget imbalance.

Candidates in this year's Louisiana election for governor are called "quirky" by the Wall Street Journal (9/6). The story features an analogy to Latin American banana republics in dealing with Governor Roemer, former Governor Edwards, and other candidates.

MISCELLANY

Census Data: The Census Bureau count of population understates actual population with a Bureau-developed adjustment available. In a controversial decision, the Bureau opted not to use its own adjustment. Legally this decision, which is being litigated, affects the apportionment of the Congress. It does not necessarily control the apportionment of state legislatures, nor the data used by states to allocate money to their political subdivisions.

The California legislature is seeking the detailed data (the state totals have been published in **Reports** and elsewhere) for use in state legislative apportionment. The Census Bureau declined to provide it. California sued and won in a lower federal court. By a 6-3 ruling, the U.S. Supreme Court has stayed execution of the lower court orders, pending review by a federal circuit court. The immediate effect will be to preclude use of the alternative data for reapportionment for the 1992 elections.

While the immediate excitement is about reapportionment, the controversy also has major effects on the allocation of federal and state aid. With the detailed data available, there is nothing to preclude either the Congress or individual state legislatures from using population estimates for grant distributions that are different from those used for legislative apportionments.

Corrections: While the National Conference of State Legislatures is predicting that states will again overrun their corrections budgets to produce double-digit increases in corrections spending, some state officials appear determined not to let that happen. In Georgia, the budget cuts adopted in a special legislative session this fall include a reduction in corrections employees. In Tennessee, Governor McWherter is increasingly critical of "trying to build our way out of this problem." Much of the concern there is with the sharp growth in convictions for cocaine possession with intent to resell. One test of public opinion on the subject will appear when Texas voters consider in November a proposed $1.1 billion bond issue for corrections.

Education Choice: There isn't an exact count, but education choice measures were part of education or budget bills this year in many states. None will result in anything dramatic happening quickly. None are self-implementing tax credits. Some have long lead times for implementation.

The Epson plan that received national publicity was rejected by a New Hampshire trial court. It ruled that local governments cannot use tax abatements except when an erroneous assessment is being corrected or taxpayer ability to pay is the issue. Supporters, including the governor, plan to push choice measures in the 1992 legislative session. Although the litigation raised broad constitutional issues, the court didn't address them, finding that its interpretation of New Hampshire tax law dictated the outcome.

The Massachusetts plan is being partly implemented, though new regulations are expected along with revisions by the legislature. Some districts have opted to receive students who elect to transfer. Agreement of the receiving district and the student's parents is all that is required to move state aid along with the student. The aid that is moved varies, but is typically the receiving district's tuition for out-of-district students. In some local situations, there have been substantial shifts which create fiscal problems for the sending district.

Education Finance Equalization: School finance litigation remains active in many states. Little dramatic is occurring because of the long periods that elapse between the filing of litigation, trial, and appeals to reach the state supreme court. One significant development occurred in August when a financing suit was filed in Montana. It is a second generation action, following previous litigation and extensive reform measures that passed in 1989.

Colorado, which did its finance equalization several years ago, is now facing problems being considered at a special September legislative session. The details, including a shift of the fiscal years of the school districts, are complex. The overall problem is that there is greater enrollment and less property tax base than originally anticipated. Higher state taxes are a possible outcome.

Education Reform: This was not a big year for education reform, other than school financing changes. Only two states passed reform measures associated with new money. The Arkansas package is already being implemented while the Missouri package depends upon voter approval of the new taxes in the November elections. After noting, "education reform defies easy description," State Government News summarizes this year's state enactments in its September issue. Of course, much of the activity is in states -- like Kentucky, Oklahoma, and New Jersey -- that are in the midst of implementing previously enacted programs.

Extension Service: Governor Miller's plan to cut Georgia spending to balance the FY 1992 budget attacked the usual targets. One exception was the cooperative extension service, where a 42% budget cut was proposed. The service, which exists in every state, was organized over 70 years ago to disseminate new agricultural technology to farmers. With fewer farmers of greater technical sophistication, the service has broadened its activities. In urban areas, homeowners use it for soil testing and advice on lawn care. While recognizing the political clout of the service, the governor commented, "Of all the cuts I have offered, this is probably the most obvious." The legislature, in its recent special session, made major cuts but not as deep as those proposed by the governor.

TECHNICAL NOTES

Health Care: The State and Local Government Labor-Management Committee (815 16th St., NW, Suite 308, Washington, DC 20006) report is Controlling Public Employee Health Care Costs Through Labor-Management Committees.

Economic Development: Table 2 comes from an article by James Gosling (U. of Wisconsin) appearing in the State And Local Government Review (Winter 1991). There is a massive gap between academic assessments of state development policies like tax concessions and what state agencies, given their time and money constraints, can use for evaluation. A short common sense list of suggestions for bridging the gap, Monitoring State Economic Development Programs: A Guide For Legislators, was recently issued by the Midwestern Legislative Conference of the Council of State Governments (641 E. Butterfield Rd., Lomard, IL 60148).

Federalism: Recent federalism issues are surveyed in the summer issue of Publius: The Journal of Federalism.

State And Local Finances: The prevailing view on the national economic importance of state and local fiscal decisions is articulately reflected in the July/August Financial Market Perspectives (published by Goldman Sachs (85 Broad St., New York, NY 10004) in an article titled, "Macro Mountains Out of Fiscal Molehills." It concludes that while there are state and local fiscal problems with serious local effects, "the resulting restraint and hardships for individual states and communities, however, should not be mistaken for a major drag on the national economy."

The Congressional Budget Office (Second and D Sts., SW, Washington, DC 20515) investment assessment is How Federal Spending for Infrastructure And Other Public Investments Affects The Economy.

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IN THIS ISSUE

New England continues to trail the nation according to the newest Index of State Economic Momentum. Job growth, income gains, expanding sales, and housing construction all tell slightly different stories about each state. But all suggest economic strength is centered in inland states -- a big change from the bicoastal economy often discussed in the 1980s.

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When state budgets and tax increases were adopted this spring and summer, state officials expected their spring and summer tax collections to show little growth. The returns are now in with little growth in many states and declines in others.

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Insurance reform efforts are continuing without making much of a dent in insurance costs. Many state initiatives are tied up in litigation.

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Actions by Illinois and Ohio to save coal mining employment show how far some states will go to save a job.

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Pension fund management issues are creating controversies in California and Kansas.

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Miscellany deals with health, local finances, mandates, and phantom voting. Technical notes indicate data sources.

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September 1991 (Second of Two Sept. Issues)

STATE ECONOMIC PERFORMANCE

National Economic Performance: As readers are aware from widespread reporting of national economic numbers, the national economy isn't doing well. The data support an interpretation that the economy is in a period of stagnation, but also support an interpretation that the economy is in the early phases of recovery.

State revenue performance is uneven whether measured in relation to individual state estimates or viewed overall. This performance, as suggested by revenue statistics in the next article, is leaving some states with fiscal problems while others are avoiding them. The most serious fiscal difficulties appear in the Southeast. The early impact of the recession was comparatively mild there. Revenue estimators apparently were banking on things not getting worse and then a reasonably quick recovery. In some of the states with the most severe problems, the revenue anticipations are so low that fairly bad news exceeds the estimates. In Massachusetts, favorable results in the last several months are causing a debate over restoring some social service cuts.

Comparing State Performance: The Index of State Economic Momentum provides an overall basis for comparing state economic growth. It is not a short term revenue estimating model, though states doing extraordinarily well or poorly in the index will generally be experiencing corresponding good or bad news in revenues. The new rankings are shown in Table 1.

The index uses three measures of economic growth in equal proportions, each reflecting growth rates for the latest 12 months for which information is available. Each of the three is compared to the national average with the differences weighted equally to provide the index. The three indicators are percentage changes in (1) population, (2) employment, and (3) personal income. For example, a state with 1% higher growth than the national average in each of these indicators would appear on the Index as +1.00.

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Table 1: Index Of State Economic Momentum September 1991

Rank	State	Index	Rank	State	Index	Rank	State	Index
1	Nevada	4.79	18	Arkansas	0.45	34	North Dakota	-0.62
2	Alaska	2.99	19	Maryland	0.20	35	Wyoming	-0.62
3	Utah	2.82	20	Kentucky	0.14	36	Pennsylvania	-0.63
4	Washington	1.96	21	Ohio	0.05	37	Alabama	-0.64
5	Arizona	1.95	22	Montana	0.03	38	Indiana	-0.66
6	Hawaii	1.68		**United States**	**0.00**	39	New York	-0.66
7	Colorado	1.23	23	Louisiana	-0.03	40	Michigan	-0.76
8	Idaho	1.14	24	South Dakota	-0.04	41	Missouri	-0.82
9	Texas	1.11	25	Illinois	-0.21	42	New Jersey	-0.89
10	Oregon	1.09	26	Virginia	-0.26	43	Iowa	-0.95
11	New Mexico	1.04	27	Mississippi	-0.29	44	West Virginia	-1.29
12	California	0.82	28	Connecticut	-0.32	45	Delaware	-1.43
13	South Carolina	0.74	29	Georgia	-0.36	46	Rhode Island	-2.02
14	Minnesota	0.51	30	North Carolina	-0.42	47	Massachusetts	-2.08
15	Nebraska	0.48	31	Kansas	-0.46	48	Maine	-2.19
16	Wisconsin	0.47	32	Tennessee	-0.59	49	Vermont	-2.31
17	Florida	0.47	33	Oklahoma	-0.59	50	New Hampshire	-3.08

A large number of states track the national economy quite closely. Sixteen are within half a percent of the average. Only 18 deviate by more than a percent, down from 24 when the index was last calculated (Issue 12). The states leading the index are predominantly Western states. The leaders include some Oil Patch states recovering from problems of the mid-1980s. They advanced sharply in the index by avoiding many of the difficulties of other states. Examples are Alaska, Colorado, and Texas -- all in the top ten. New England states monopolize the bottom ranks.

And The Last Shall Be First: It is difficult for a state to deviate much from national average growth for long. Extraordinary growth tends to lead to overheating and an eventual correction, which is how New England states moved from the top of the list several years ago to the bottom now. Local recession encourages people to move out and certain kinds of business to expand, eventually paving the way for growth from a downsized and transformed economic base. This is how states like Colorado, Oklahoma, and Texas have moved up in rankings.

There are signs that Nevada may be losing its massive edge over other states. Its margin over the national average has dropped since last quarter's index. Fiscal problems are beginning to appear as evidenced by a tax increase this year and a budget shortfall developing in FY 1992 as revenues are falling below estimates.

Personal Income Change: The personal income growth between the first quarter of 1990 and the first quarter of 1991 is shown in Table 2.

Table 2: Percent Change In Personal Income, First Quarter 1990 and 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	7.4%	18	Arkansas	4.3%	34	Michigan	3.4%
2	Utah	7.4	19	California	4.3	35	South Dakota	3.4
3	Alaska	7.3	20	Kentucky	4.3	36	Kansas	3.3
4	Nevada	7.0	21	Idaho	4.2	37	Maryland	3.3
5	New Mexico	6.7	22	Oklahoma	4.1	38	Missouri	3.1
6	Colorado	5.9	23	Pennsylvania	4.1	39	Georgia	2.9
7	Louisiana	5.9	24	Tennessee	4.1	40	Indiana	2.9
8	Texas	5.9	25	Wisconsin	4.1	41	Virginia	2.9
9	Oregon	5.6	26	Montana	4.0	42	Nebraska	2.7
10	Washington	5.4		**United States**	**4.0**	43	North Carolina	2.6
11	Arizona	5.1	27	Ohio	4.0	44	Iowa	2.4
12	Illinois	4.9	28	North Dakota	3.9	45	Delaware	1.5
13	South Carolina	4.9	29	New York	3.8	46	Maine	1.3
14	West Virginia	4.7	30	Alabama	3.7	47	Massachusetts	1.1
15	Mississippi	4.6	31	Florida	3.7	48	Rhode Island	1.1
16	Minnesota	4.5	32	New Jersey	3.7	49	Vermont	0.9
17	Wyoming	4.4	33	Connecticut	3.6	50	New Hampshire	-0.7

Although many people probably think of recession as associated with declines in income and perhaps declines in state and local tax revenue, declines have been uncommon since the Depression. Personal income tends to rise with pay boosts for the persons who remain at work and with growing interest and rental income and transfer payments, such as Social Security. Nationally, personal income in the first quarter was 4% above the previous year's first quarter. Only New Hampshire suffered a decline.

In broad terms, revenue from existing state and local taxes tends to increase at roughly the same rate as personal income. At a minimum, spending is likely to grow to match the combination of inflation (about 4%) plus population growth (1% nationally with much variation among states). With 39 states below 5% in Table 2, it isn't difficult to see why many state and local governments have increased taxes in the past year.

Job Losses: Employment change, the third component of the Index of State Economic Momentum, is one of the most sensitive indicators of economic change. The state-by-state changes are shown in Table 3.

Table 3: Percent Change In Employment May Of 1990 And 1991

Rank	State	Percent	Jobs (000)	Rank	State	Percent	Jobs (000)
1	Nebraska	4.44%	33	27	Illinois	0.17%	9
2	Utah	3.88	28	28	Mississippi	-0.10	-1
3	Idaho	3.49	13	29	Alabama	-0.21	-4
4	Arkansas	2.93	27	30	Indiara	-0.31	-8
5	Nevada	2.86	18	31	California	-0.46	-60
6	South Dakota	2.64	8		**United States**	**-.50**	**-553**
7	Colorado	2.10	32	32	Florida	-0.86	-47
8	Washington	1.88	40	33	Maryland	-0.86	-19
9	Wyoming	1.80	4	34	Tennessee	-0.92	-20
10	South Carolina	1.56	24	35	Pennsylvania	-0.97	-51
11	Hawaii	1.42	8	36	Georgia	-1.05	-32
12	Arizona	1.38	21	37	Delaware	-1.08	-4
13	Louisiana	1.36	22	38	Missouri	-1.09	-26
14	North Dakota	1.11	3	39	North Carolina	-1.11	-35
15	Texas	1.08	76	40	West Virginia	-1.54	-10
16	Alaska	1.00	2	41	Virginia	-1.56	-45
17	Kentucky	0.92	14	42	Michigan	-2.22	-88
18	New Mexico	0.88	5	43	New York	-2.26	-187
19	Iowa	0.66	8	44	Connecticut	-2.26	-37
20	Wisconsin	0.55	12	45	New Jersey	-2.47	-91
21	Oregon	0.52	6	46	Vermont	-3.42	-9
22	Kansas	0.46	5	47	Rhode Island	-3.90	-18
23	Montana	0.43	1	48	Maine	-4.73	-26
24	Ohio	0.37	18	49	New Hampshire	-5.11	-26
25	Minnesota	0.32	7	50	Massachusetts	-5.24	-157
26	Oklahoma	0.24	3				

There is a strong regional pattern in job gains and losses. The top nine states in Table 3 are West of the Mississippi. The bottom eleven are East of the Mississippi. The industrial Midwestern states, usually the primary victims of recession, didn't do badly in maintaining employment.

Retail Sales: Retail sales provide another indicator of how state and national economies are doing. The news hasn't been good as shown in Table 4. The state statistics are available only for the large states listed.

Table 4: Percent Change In Retail Sales, First Half 1990 and 1991

State	Percent	State	Percent
Minnesota	6.9%	Michigan	1.1%
Indiana	6.6	**United States**	**0.6**
Texas	5.5	North Carolina	0.3
Ohio	4.5	Massachusetts	-1.0
Florida	4.1	New York	-1.3
Missouri	3.6	California	-1.8
Louisiana	3.0	New Jersey	-1.8
Tennessee	2.1	Wisconsin	-2.6
Illinois	1.9	Pennsylvania	-3.8
Maryland	1.3	Virginia	-6.2

In the late 1980s, there was considerable discussion of the "bicoastal economy." The theory was that the nation's growth was concentrated on the Atlantic and Pacific coasts, while the rest of the country stagnated. The table is a strong indication of the reverse phenomenon.

Housing Starts: Economic growth in many areas has been fueled by construction of residences and office buildings, much of it in anticipation of continued growth. If growth fails to occur, construction grinds to a halt. Speculative building ends while building to meet normal growth is unnecessary until existing unoccupied buildings are filled. The corrections are most dramatic where the growth has been fastest, as in New England. Nationally, the resumption of growth has been slowed by tighter lending standards for banks and S&LS. Cutbacks in housing (see Table 6 in the following article) are most severe in the Northeast but increasingly include California and parts of the South. They are least severe where economies were sluggish in the mid- to late-1980s, oil and gas states and the industrial Midwest.

STATE AND LOCAL TAX REVENUES

The Economy And State And Local Revenues: State and local revenues aren't growing as rapidly as in the late 1980s. This isn't surprising as the economy isn't growing as rapidly. So there is less income growth, slower sales growth, and less new property to be taxed. However, some states are discovering worse news -- that state and local revenues aren't always keeping pace even with the slow pace of nominal (unadjusted for inflation) economic growth. The overall reason is that growth is concentrated in non-taxable activities while contraction is concentrated in what state and local governments use as their tax bases.

Income Tax Revenues: The concentration of growth in nontaxable areas is most obvious in personal income growth and income taxes. Nationwide, personal income grew by 3.6% between the second quarter of 1990 and this year's second quarter. But wage and salary income, the mainstay of the state income tax base and sole component of local wage tax bases, grew by only 2.9%. The fastest growth was in transfer payments like Social Security, Unemployment Compensation benefits, federal and private retirement benefit payments, and welfare payments. These are generally either not reached at all by state income taxes, or only partially reached. Transfer payment income grew by 10.5%, more than three times the 2.9% growth rate for wages and salaries.

Sales Tax Revenues: A similar problem is appearing in the sales tax. For openers, not all personal income is available for consumption spending of any kind. While experiencing a 3.6% increase in wage and salary payments, consumers saw a 6.7% increase in contributions for social insurance, primarily their FICA (Social Security) withholding. This cut what they had available to spend on goods and services.

Within their budgets for personal consumption, their spending priority tended to go for medical care, household operations, and transportation -- with purchases of goods cut back as necessary to make ends meet. The results are portrayed in Table 5.

Table 5: Consumer Spending, Second Quarters 1990 and 1991
Seasonally Adj. At Annual Rates, $ billions

Category	Amount 1991	Change	Pct. Ch.
Personal Consumption Total	$3,791	$168	4.6%
Durable Goods, Total	454	-24	-5.1
Motor Vehicles And Parts	188	-24	-11.4
Furniture And Household Equip.	176	0	-0.2
Other Durable	89	0	0.0
Nondurable Goods, Total	1,223	44	3.7
Food	643	20	3.2
Clothing and Shoes	219	6	2.8
Gasoline and Oil	91	7	8.0
Other Nondurable	270	11	4.3
Services	2114	149	7.6
Housing	592	29	5.1
Household Ops. (e.g. utilities)	221	10	4.5
Transportation	147	12	8.6
Medical Care	530	54	11.3
Other Services	624	45	7.8

One way of looking at these data is that consumers used nearly their entire nominal purchasing power growth for the purchase of services, leaving essentially no growth in purchases of durable and nondurable goods. With no gain in sales volume in these items, there tends to be no growth in state and local sales taxes either. Another way of viewing the situation is that consumers devoted their entire spending increase to food and services, with no growth in other categories.

The same conclusion arises from retail sales data as shown in Table 4, but classified by type of store making the sales. Stores selling items not generally subject to the general sales tax did well: restaurants and bars (3.8%), liquor stores (5.7%), service stations (4.7%), food stores (3.1%), and even mail order houses (2.4%). Those selling sales-taxed items did less well: department and variety stores (2.2%), clothing stores (0.4%), furniture stores (-5.2%), camera stores (-10.4%), and auto dealers (-4.6%).

Property Taxes: The property tax remains the mainstay of local finances. To the extent they rely on other major taxes, such as local sales or income taxes, local revenues are subject to the same problems as state revenues.

One virtue of the property tax is its relative insensitivity to recession. However, it isn't totally insensitive for two reasons. First, new property represents a significant portion of property tax revenue growth, particularly in those jurisdictions that assess new property at market value but other property at something less. So a slowdown in new construction cuts property tax revenue growth. Second, although the gaps are considerable in some jurisdictions, property assessments bear some relationship to market values. Stagnant or declining values slow or eliminate growth in the property tax base. The results can be dramatic for commercial property, such as that repurchased in foreclosure proceedings, and industrial property that is partly abandoned as productive facilities.

Property Values In Individual States: Table 6 gives a rough indication of the pressures on property tax revenues as well as how the states compare in economic indicators. It shows for selected states the change in residential building permits from the first half of 1990 to the first half of 1991. Then, for a city in the states shown, it provides the change in median home prices in the second quarter of 1991 relative to the second quarter in 1990.

Table 6: Changes In Building Permits And Prices, 1990 And 1991

State	Permits	Metro Area	Price Change
Colorado	38%	Denver	3%
Utah	20	Salt Lake	8
Oklahoma	3	Oklahoma City	4
Texas	-6	Fort Worth	-1
Minnesota	-12	Minneapolis	2
Pennsylvania	-12	Philadelphia	1
Arizona	-13	Phoenix	2
Kansas	-13	Wichita	5
North Carolina	-17	Charlotte	5
Georgia	-18	Atlanta	0
New York	-20	New York	-2
Michigan	-21	Detroit	2
Ohio	-21	Columbus	4
United States	-25	**United States**	5
Illinois	-26	Chicago	6
Virginia	-29	Richmond	5
Massachusetts	-30	Boston	-3
Florida	-32	Miami	4
Washington	-36	Seattle	-3
Oregon	-40	Portland	8
California	-44	Los Angeles	1
New Jersey	-45	Bergen/Passiac	-3

Property Tax Increases: Despite relative stagnation in property values and restrictions on property tax levies in many states, there are strong indications that property taxes are rising rapidly. This would be an understandable reaction of local officials to cuts in federal aid and state aid that has been curtailed by state fiscal circumstances. For the 12 months ending in March, the Census Bureau estimates that property tax revenues rose 6.3%. During the same period, all state taxes had revenue growth of 3.5%. For the second quarter, the estimate of property tax growth over the second quarter of 1990 is 6.5% versus 4.6% for personal income taxes and 4.7% for sales taxes.

Current data aren't available for most property taxing jurisdictions, but the Census Bureau does have information for some large ones, which are all counties except for New York City. Table 7 shows the increase in property tax collections between the 12 months ending in March and the prior year for jurisdictions that collect more than a billion dollars a year in property taxes. If these larger jurisdictions are any indication, many property tax increases were double digit. These increases reflect both rate increases and increases in the value of property taxed resulting from new construction and higher assessments of existing property.

Table 7: Percent Change In Property Tax Collections
Twelve Months Ending In March Of 1990 And 1991

Jurisdiction	State	Change	Jurisdiction	State	Change
Santa Clara	California	20.2%	Bergen	New Jersey	9.7%
Los Angeles	California	17.3	Westchester	New York	9.2
Broward	Florida	15.6	Maricopa	Arizona	8.9
Allegheny	Pennsylvania	14.1	Oakland	Michigan	8.2
Hartford	Connecticut	12.8	King	Washington	7.0
Cuyahoga	Ohio	12.4	Cook	Illinois	5.5
New York City	New York	11.9	Hennepin	Minnesota	5.2
Orange	California	11.5	Middlesex	Massachusetts	4.4
Fairfax	Virginia	11.3	Dallas	Texas	4.0
San Diego	California	10.2	Nassau	New York	3.5
Wayne	Michigan	10.2	Harris	Texas	2.2
Palm Beach	Florida	9.9	Suffolk	New York	-6.3
Fairfield	Connecticut	9.8			

State Revenues Lag: The revenue problems appear in data now being released on revenue collections in individual states, particularly those that didn't increase taxes for FY 1991. State revenues will show more substantial gains beginning with the third quarter because many state tax increases are now beginning to have an effect. The overall revenue picture is suggested by reports from Census and the Center for the Study of the States. These cover differing periods: (1) Census covers 12 months ending in March, (2) Center Q covers the second quarter of 1991 compared with the second quarter of 1990, and (3) Center FY covers the year ending in June of 1991, which is FY 1991 for most states, in relation to the prior year. Rates of growth are shown in Table 8.

Table 8: Growth In State Revenues, Selected Periods

Revenue Category	Census	Center Q	Center FY
TOTAL REVENUES	3.5%	2.0%	3.2%
Personal Income	4.3	3.4	4.8
Corporate Income	-8.9	-1.7	-5.2
Sales	3.7	0.8	2.5

The similarities in the estimates are more significant that the differences. By all reckoning, state revenues haven't been growing as rapidly as inflation, which is 3-5% depending on measurement concept and period measured. Steven Gold, who collected the Center's data, reports that the 2% increase of the second quarter would have been a 1% drop if states hadn't increased their tax rates.

Revenue Growth In Individual States: Table 9 provides the Center's estimates of revenue increases in the individual states for what is FY 1991 in all but four of them.

Table 9: Growth In Tax Revenues, FY 1990-FY 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Kentucky	22.5%	18	Arkansas	5.2%	34	Rhode Island	1.5%
2	Nebraska	18.6	19	Iowa	5.1	35	Indiana	1.4
3	New Jersey	14.3	20	North Dakota	5.1	36	Georgia	1.1
4	Oklahoma	14.1	21	South Dakota	5.1	37	Tennessee	1.0
5	Hawaii	12.7	22	Wyoming	4.8	38	South Carolina	0.6
6	Arizona	12.6	23	Alabama	4.2	39	Vermont	0.4
7	Texas	11.8	24	Montana	4.2	40	Ohio	0.1
8	Oregon	10.0	25	Kansas	4.0	41	Delaware	-0.1
9	New Mexico	8.5	26	New Hampshire	4.0	42	Virginia	-0.4
10	Wisconsin	7.8	27	Illinois	3.8	43	California	-0.7
11	Washington	7.5	28	Mississippi	3.8	44	Maryland	-0.8
12	West Virginia	7.5	29	Missouri	3.6	45	Michigan	-1.2
13	Idaho	7.3	30	New York	3.4	46	Pennsylvania	-1.6
14	Utah	7.0	31	Minnesota	3.3	47	Maine	-3.5
15	Louisiana	6.7		**United States**	3.2	48	Nevada	-3.6
16	Massachusetts	5.8	32	Florida	2.1	49	Connecticut	-4.6
17	Colorado	5.6	33	North Carolina	2.0		Alaska	n.a.

The negative numbers are the most striking aspect of the table. Most of the states with shrinking revenues have raised the taxes to be collected in FY 1992. Most of the states with double digit revenue increases had raised taxes in their 1990 legislative sessions, so their increase in collections appears in FY 1991.

INSURANCE REGULATION

Introduction: The failures of several large insurance companies have caused most concerns about state insurance regulation function to center on the task of making sure that companies maintain solvency so they can pay promised benefits. Another aspect of insurance regulation is protection of the consumer by reviewing and approving policy provisions and rates. This was a hot topic in the late 1980s, particularly with approval of Proposition 103 in California in 1988. This triggered consideration of comparable regulatory measures in other states. In addition, unique problems in auto insurance caused New Jersey and

Pennsylvania to adopt controversial reforms. This article summarizes what has been happening this year.

Ebb And Flow In State Policy: The examples of recent activity show there is little consensus about appropriate state policy on some major issues. As a result, "reform" in one state may be the exact opposite of reform in another. California reformed insurance regulation by making the commissioner elected rather than appointed. Faced with failure of a major company and scandal affecting the commissioner, Louisiana reformers are looking at appointing rather than electing the commissioner. One Georgia reform was to repeal an old reform, no-fault, while Pennsylvania's reform was to add a no-fault option. Nevada had no-fault in the 1970s, repealed it, and considered reenacting it this year. Texas reformed regulation of Workers' Compensation (WC) insurance by deregulation of rates while Georgia reformed auto insurance by reregulation. New Jersey's reform of auto insurance included eliminating a state-run plan. The Texas reform of Workers' Compensation creates a state-run plan.

State Government As An Insurer: State governments are in the insurance business in a big way. The states are insurers in Unemployment Insurance with a monopoly on this insurance line. A few states maintain a similar monopoly for Workers' Compensation Insurance, but use of private carriers is more common. There are other isolated cases of state operation of the insurance function, such as a new earthquake insurance program in California and a special medical malpractice coverage for delivery of babies in Virginia. Pennsylvania tried, but abandoned, taking a portion of auto insurance coverage with the rest handled by private companies. States don't participate in other insurance lines like fire and casualty, auto insurance, and life insurance.

The state decisions on where to be involved in the insurance function tend to be quite stable, with patterns in each decade closely resembling the prior one. In that context, a Texas decision this year represents substantial change. Like most states, Texas officials haven't been happy with their WC system as employer costs soared while employee benefits stagnated. A reform measure was passed in 1989 which is just now starting to take effect. But reform didn't solve the problem of the Texas Workers Compensation Insurance Facility, which is basically an assigned risk plan. Like many such plans, its costs have exceeded revenues, leaving a deficit of over $1 billion. The deficit is the responsibility of companies selling WC insurance in proportion to their sales. But WC rates are tightly regulated in Texas. Regulators have tried to hold down rates, creating what insurers claim are major losses even without increased assessments for the assigned risk plan.

The basic solution in the new legislation is rate deregulation, putting Texas in line with many other states depending on competitive pressures rather than rate regulation as the primary control over rates. The interesting wrinkle is a new state-run insurance fund that will compete with the companies. The fund will get its capital through a $5 million loan from the state and revenue bonds. It is supposed to be self-supporting over time. Because it won't be subject to the same premiums taxes and won't have to participate in paying off the deficit from the assigned risk plan, it should have an initial advantage over the companies. Critics of the idea were mollified when the legislature included an amendment that sets a sunset date in 1995, causing the fund to cease to exist if not renewed by the legislature.

Texas Insurance Regulation: As the 1991 legislative session began, newly elected Governor Richards was highly critical of the state's insurance agency. She urged reform in how the agency was governed and in insurance law. A fierce battle was expected in the legislature. It didn't materialize. Instead, consumer groups, legislators, representatives of the governor, and insurance company personnel negotiated a bill covering, in over 500 pages, many facets of insurance regulation.

The industry gets deregulation of rates under the name of "flex rating." It allows carriers to deviate up to 30% from a state-set benchmark rate. Flex rating applies to auto and homeowners' insurance. General liability and commercial property insurance is fully deregulated. The industry loses protection from state level antitrust laws. The board of insurance is reorganized into a department with a single insurance commissioner to govern day-to-day activities.

California's Proposition 103: One provision of Proposition 103 was that the insurance commissioner would be elected rather than appointed. In January, the first elected commissioner took office with a pledge to reduce insurance rates. Proposition 103 called for a 20% premium rollback. Insurance companies contested the provision, securing a state supreme court opinion that they deserved a fair rate of return. This made their status similar to that of electric and telephone utilities. The problem was that if this rate of return were allowed, the 20% cutback wouldn't take place and some companies would actually get rate increases. Considerable activity followed -- litigation, negotiation, rulemaking, attempts to resolve the matter by legislation, and more. But nothing happened that consumers would notice as rate relief.

In August, the new commissioner announced regulations that he said would result in $2.5 billion in refunds, over $100 per policy holder. They included limits on company costs allowed for executive salaries, political contributions and lobbying, and an efficiency standard for other expenses. The commissioner said, "These regulations establish California as the nation's leader in consumer protection." The key factor in the rate reductions was a determination that 10%, not the higher 11.2% used earlier, was the appropriate and legal rate of return. The move was announced with considerable fanfare that drew nationwide publicity. It also drew negative comments from industry sources. They claimed that the "Alice-in-Wonderland regulation" did nothing about the underlying costs of insurance -- accidents, theft, fraud, litigation, and the costs of health care.

Court challenges to the rollback were expected, but the approval in California's administrative law procedure was expected to be quick. It wasn't. In early September, the Office of Administrative Law rejected the new regulations. It interpreted the law as requiring hearings before promulgation.

On a separate track, California legislators considered insurance reform measures in the 1991 session, but didn't pass one. A leading concept involved no-fault, a bare-bones policy to appeal to the third of California drivers who illegally drive without insurance. An alternative, backed by trial lawyers and others, would make insurance more affordable for low-income drivers by extra premiums charged to high income drivers.

Reform In New Jersey: New Jersey's auto reform passed in March of 1990, redeeming one of Governor Florio's campaign promises. It was designed to cut auto insurance rates in part by removing the albatross of $3 billion in deficit of the assigned risk plan, known as the Joint Underwriting Association (JUA). It is to be handled by increased taxes and fees and by making auto insurers absorb $1.4 billion without passing the costs along to policyholders. The immediate impact of reform was to cut about $200 off annual bills of the average driver. This April the governor borrowed the original Batmobile to celebrate the removal of the charges.

The financing problems aren't necessarily over as the new assigned risk plan, the Transitional Market Facility, may itself start running up debts. Representatives of major auto insurers and legislators critical of the reforms worried that the decisions on rates for the new plan would recreate the problems of the old. The companies sued to invalidate the new law, but lost a state supreme court decision in May. Companies argued that the new law made it impossible to earn a fair rate of return, the same argument used against Proposition 103 in California. The court rejected the argument, suggesting that through the normal rate making procedure such a rate of return was possible. Companies are free to return to court if rate decisions don't provide them a return they consider fair.

The possibility that companies might try to leave the state rather than absorb the costs was anticipated. Companies that leave must leave all insurance business in the state, including profitable lines as well as auto insurance they find unprofitable. To get out, they must go through an extensive transition of up to five years. A state appeals court upheld this "all or nothing" rule this summer.

In September, Allstate, which is the largest New Jersey auto insurer, announced that it was pulling out. By its reckoning, it lost $72 million in New Jersey last year and $450 million in the last two decades. The decision affects insurance on 435,000 cars and, under the "all or nothing rule," about 250,000 homes and large numbers of boats and recreational vehicles. The governor said the state wouldn't be blackmailed into a 28% rate increase and continued:

> When I was growing up in Brooklyn, there was always one boy who would say that if you didn't play by his rules he would take his bat and ball and go home. If that's what an insurance company wants to do, we won't back down from our commitment to fairness for drivers and reasonable rates.

The Allstate decision is being announced in 800,000 letters to policyholders, so it won't be easily reversed. But the company and Garden State regulators could reach some sort of accommodation in the five years it will take to complete the pullout under state law. Critics of reform seized on the announcement as an indication of the failure of state policy. Second-ranked State Farm called Allstate's criticism of New Jersey's operating environment accurate, but is remaining in the state.

Overall, it is too early to tell what impact the reform program is having. The new taxes and fees on body shops, doctors, and vehicles are in place, reducing amounts that would otherwise be in insurance bills. The JUA surcharge has ended. Whether auto rates will eventually rise to cover the past deficit remains to be seen.

Pennsylvania Reforms: Last year's Pennsylvania reform package adopted a limited form of no-fault insurance. Drivers can close a limited-tort option that waives certain of their rights to sue for non-economic damages like pain and suffering. In return, they get lower rates. Only about a third of Keystone State drivers have accepted the option, but state officials believe acceptance will spread as understanding increases. Other options touted as cost saving actually shift risks. Examples are raising the collision deductible, reducing medical coverage, and eliminating uninsured motorist coverage. The state insurance agency says that savings in the first year have been at least $400 million. Rates are still high by national standards, over $800 statewide and over $1,000 in Philadelphia.

Dropping No-fault In Georgia: Reforms enacted in Georgia reverse some of the reforms of prior years. The state is replacing "file and use" rate regulation for auto insurance with a system requiring prior state approval of new rates.

Georgia is also dropping its no-fault system. Georgia was one of many states that reacted to no-fault pressures in the 1970s by a compromise that set a low no-fault threshold. In Michigan's comprehensive no-fault plan, medical benefits are unlimited. In Georgia they were limited to $5,000. In Michigan, permanent injury is required to leave the no-fault system to sue, but in Georgia only $500 in medical outlays was required. The hybrid system was generally seen as costing more than either a higher threshold no-fault or a fault system. Georgia opted to return to the fault system, hoping the decision along with other reforms, such as tighter rules against fraudulent claims, will produce lower premiums. One concern is that some of the costs will quickly appear as uncompensated health care costs, as immediate reimbursement for medical expenses will no longer be available.

KING COAL

Introduction: New federal clean air legislation was hung up for years over the issue of emissions from coal-burning powerplants in the Midwest. Standards stringent enough to satisfy environmentalists and Members of Congress from downwind Eastern states carried unacceptable costs in lost jobs and power prices in the Midwest. The ultimate compromise which was adopted in 1990 required plants burning high sulphur coal to change their ways. In broad terms, the choices were: (1) continuing to use high-sulphur coal and investing heavily in scrubbers to take sulphur compounds out of the air or (2) substituting low sulphur coal for high sulphur coal.

The Issue: The low sulphur coal alternative was deemed preferable in analyses by major companies in Ohio and Illinois. With both alternatives meeting air pollution goals, the key factor in the analysis was cost, which under rate regulation logics of both states would be passed on to consumers.

The low sulphur choice meant switching from local coal mined in Southern Illinois and Southeastern Ohio. That coal has high sulphur content which cannot economically be removed, though both the coal and electric companies and the State of Ohio have invested in R&D on reducing sulphur content. The beneficiaries of the switch would be coal companies and miners in the West.

The Decisions: The Illinois decision was contained in legislation passed this year. In substance, it requires the use of Illinois high sulphur coal at the Illinois plants involved. It is expected to save something like 2,500 mining jobs. The cost is estimated to be about $1 a month (starting in 1995) to residential electric customers of the company serving the Chicago area.

The Ohio problem was concentrated in one plant owned by the seven-state holding company American Electric Power (AEP). The plant's coal is supplied by an Ohio mine owned by the company. The legislative solution was to seek to protect the 1,200-1,300 mining jobs by offering a tax credit. The credit is $1 per ton for companies that opt to burn Ohio coal and use scrubbers. The legislation covers plants that already have scrubbers, bringing its estimated cost to about $20 million annually and the coal mining jobs involved to about 7,000.

Under the Ohio law, AEP is not required to burn Ohio coal. With the compliance date in 1995, it still has time to make a decision. While the legislation was being considered, company officials indicated that even with its incentives, closing the mine might be appropriate. A company official estimated that the credit would be about $6 million annually, while the cost of compliance would range from $125 million to $230 million.

In signing the legislation, Governor Voinovich was critical of his predecessor for not taking more effective action to prevent passage of the federal legislation. Voinovich characterized the legislation as a "Western coal, Northeastern legislator, Texas combination that got together to put the Ohio coal industry out of business." Two statistics on the legislation are widely used in Ohio. First, Ohio is responsible for only 11% of the acid rain problem but 20% of the cleanup costs. Second, electric rates in Ohio will increase about 15% because of cleanup costs.

The Math: There was considerable controversy over the substance of the Illinois bill as well as the cost of the scrubbers. They have an initial acquisition cost, maintenance costs, and energy costs from their operations. Predicting the costs of the alternative, purchases of low sulphur coal, isn't easy either. At one point in the debate, Commonwealth Edison suggested a cost of $100 million a year. Using that cost and 2,500 jobs at stake, the cost per job is $40,000 per year. Assuming one job is generated indirectly through a multiplier effect for each coal mining job, the cost is $20,000 per job per year. The cost is paid by ratepayers to the company. There are no state government outlays nor any reduction in state tax revenue.

In Ohio, there are 7,000 jobs and an annual cost of $20 million per year. That works out to a more moderate price per job saved of just under $3,000. The problem is that the calculation includes some jobs already saved because of scrubbers previously installed. Focusing on the AEP decision involves $6 billion and about 1,250 jobs or about $4,800 a job -- $2,400 if the multiplier is considered.

Debating The Issue: In Illinois, there was concern that any gain in jobs from the legislation would be offset by losses associated with higher utility rates for industrial activities. At one point, the Illinois Manufacturers' Association and Illinois Industrial Utility Consumers were opposing the legislation, along with some consumer groups.

Utility rate regulation is beyond the understanding (or interest) of many voters. The element that the Ohio subsidy would be returned to ratepayers was stressed by proponents. This would occur in any case as the subsidy would reduce the company's allowable cost. In Ohio, the general taxpayer supports saving the mining jobs while in Illinois the ratepayer does so.

These state decisions were about as clear a case of whether to spend money to save existing jobs as will likely be found at the state level. The case against action was presented editorially by the Chicago Tribune (6/4):

> It's not that coal miners or their communities are undeserving. But instead of taxing Edison customers indirectly, the state ought to tax directly and allocate the money openly, probably to supplement federal aid for displaced workers. The miners could retrain or move to another place where prospects are better. In any case, the state's function ought to be to help people adjust to and find work in emerging industries, not to artificially prop up weak ones.

In both states, more than just saving jobs was involved. The mining jobs are located in depressed areas of the state while the subsidies will come from more prosperous areas.

Other States: Other states that produce high sulphur coal have similar issues, though with different twists. In Kentucky, much of the high sulphur coal production is sold to utilities in other states and to the Tennessee Valley Authority, a federal government corporation. Kentucky cannot force use of high sulphur coal through regulation, like Illinois does, because it doesn't have jurisdiction over the companies. A credit against Kentucky utility taxes, following Ohio's approach, won't work in all cases either because there is no Kentucky tax involved. The obvious option is to provide tax credits to the Kentucky coal producers to reduce the cost of Kentucky coal. A more exotic option is to somehow become involved in buying and selling the new federally created pollution control credits that are a part of the complex federal law. There is also a difficult equity issue as the in-state privately owned utilities already have scrubbers but might need to be subsidized, as Ohio did, in the name of fair treatment for the companies and their customers.

In West Virginia, the issues are complicated because natural gas suppliers are offering their product as an alternative to both local coal and Western low sulphur coal.

STATE PENSION FUNDS

Funding Pension Plans: Many states reduced their contributions to pension plans as one way of dealing with fiscal problems. In states which manage local pension plans, such as those for teachers, the changes also relieved local fiscal pressures. The most common adjustment was to increase the assumed rate of return on pension fund investments. This enters the actuarial calculation and results in a lower employer contribution requirement. The risk is that the assumed return will exceed actual returns, so state and local contribution increases will eventually be required to cover the shortfall.

Assumed rates of return are now in the 7-9% range. This compares with about 5-6% on U.S. Treasury bills, 8% on long-term federal bonds, 9% on corporate bonds, and fluctuating total return on common stocks that has been double digit in the past year. In this environment, the 7-9% assumptions aren't necessarily out of line. But they are unlikely to be exceeded in the way that the 4-7% assumptions were exceeded in the late 1980s.

Over the past two years there have been many reductions in government contributions to pension plans as a percentage of covered payroll. But the payrolls themselves have been rising. In the fourth quarter of 1990, those contributions were $6.5 billion, up from $6.0 billion in the same quarter of 1989, but up less from $6.4 billion in the fourth quarter of 1988. During the fourth quarter of 1990, the plans collected $20.9 million from those contributions, employee contributions ($3.1 billion), and investment earnings ($11.3 billion). Spending for employee benefits was $8.3 billion. Total assets of the plans at the end of 1990 were $620.7 billion, up 8.6% from the previous year. The plans hold nearly $50,000 for each active employee.

Pension Fund Investing In Kansas: Kansas legislators have been holding hearings assessing an estimated $200 million in investment losses in the public employee retirement system. Kansas officials are pursuing criminal prosecution and civil litigation against those involved. It isn't clear that any money will be recouped. Legislation will probably develop out of the well-publicized losses, including restrictions on fund investments. Many of the investments involved attempts to promote economic development by investing in companies expanding job opportunities in Kansas. The largest single loss was $65 million in a failed S&L.

Rightly or wrongly, the Kansas experience will be a setback for "social investing" by pension funds. Many pension fund administrators oppose such investments and will cite Kansas as an example. They will also use Alaska as an example, though it suggests problems of concentrating investments as much as problems related to social investing. Like many plans, Alaska's invested in mortgages but was heavily concentrated in Alaska housing which suffered greatly in the 1980s. There was a special problem with the Alaska Supplemental Benefits System, which employees view as their own money. It has lost about $6,000 per involved employee, about 20% of its assets. Rather than adjusting employee benefits, as state officials suggested, Alaska employees pushed for the state to replace the losses, which the legislature did this year.

Pension Politics In California: This year California drew national attention for its state pension plan issues. Faced with a budget gap of an estimated $14.3 billion, the governor proposed numerous revisions in the complex public employee system which has several benefit tiers. With substantial adjustments, those affecting benefits were adopted while those affecting governance of the funds were not. The tiers, which made some benefits contingent on investment performance, are being replaced with a guaranteed cost of living increase of at least 75% of inflation. A new retirement system will be in effect for new employees. A reduction in state costs of $1.8 billion is provided by recognizing assets of the other tiers as first tier assets.

The politics of the changes got rough. The pension fund (CalPERS) trustees representing employees attacked the California Taxpayers Association. The business-sponsored research group (comparable to public expenditure councils in some other states) had been particularly critical of the old pension system in reports like *Excessive Pensions: Fiscal Equivalent of Gutter Flooding*. The trustees contacted firms supporting Cal-Tax suggesting a boycott of their products was possible. At least one company withdrew from the organization as a result. After passage, a coalition of public employee organizations filed suit to block the changes. Pension system administrators generated national publicity to the effect that the governor was seeking to end the system's active involvement in management of companies in which the system holds stock.

Pension Fund Activism: In the midst of the debate over reorganization of the CalPERS board, many national reporters bought the story that the attempt to eliminate employee/pensioner votes on the CalPERS board stemmed from the activism of the board in corporate governance issues. It has been a leader in taking an active investor role in such issues as potentially excessive compensation of corporate officers. The allegation was that the governor was serving large business interests by trying to remove those involved. The governor denied this. The denial is at least plausible as other governors have taken positions similar to his in states where employee retirement systems have taken no role in corporate governance issues.

CalPERS' activism is controversial among state pension plan administrators. New York Comptroller Regan, who is the trustee for the major New York plans, has criticized the approach. He sees headline-producing attacks on corporate officials as "sucking us all into a pit" unless closely tied to the fiduciary duty to obtain the best return on plan assets. He fears that activism and allowing pension funds to be used for non-pension purposes will make it easier for state officials to balance budgets by denying money to pension funds.

MISCELLANY

Health Care: Acting as chairman of the National Governors' Association Committee on Human Resources, Maine's Governor McKernan wrote Congressional leaders in mid-September to seek action to forestall regulations on bootstrap financing. The regulations would restrict state use of donated funds and taxes on health care providers to provide the state match for federal Medicaid funds. If the funds are disallowed as match, the affected states will have to supply the money from other sources or curtail Medicaid spending substantially. McKernan noted that the federal timing, with an effective date of January 1, ignores the reality of state fiscal years and predicted "immediate and severe disruption of state Medicaid programs."

Local Finances: Recent surveys by the National League of Cities and National Association of Counties show the responding local governments to be in poorer-than-usual fiscal shape. But problems are by no means uniform. Naturally, they are worse in the Northeast where the economy is in worst shape. High reliance on property taxes has shielded many local governments from losing revenue because of falling sales. The most significant problems are in the jurisdictions that are most like states. That is, they rely on sales or income as a tax base and have significant responsibilities for health and welfare programs. While temporarily out of the news, the District of Columbia, New York, and Philadelphia have continuing severe problems.

Federal Mandates: The National Conference of State Legislatures is now publishing regularly its Mandate Watch List which monitors the status of federal legislation containing federal mandates on state and local government. It also released a special study at its August annual meeting titled Fiscal Impact Of Proposed Mandates From the 102nd Congress. The documents suggest how large the potential for new mandates is. The Monitor's list runs 13 pages. Many mandates are associated with health and human service programs, but the subjects include bass fishing, voter registration, and proposed restrictions on state lotteries.

Phantom Voting: When a vote of 100-80 is reported on a bill in a state legislature, does this really mean that 100 legislators were present when the vote was taken and voted for the measure? The answer is not necessarily, even with electronic voting mechanisms. Procedures and customs develop to handle situations where the intent of the legislator is well known and the absence is brief. Because they could be seized upon by the press or by counsel attempting to void legislation, there is every reason for them not to be discussed. However, in the hard-fought battles of state budgets, these mechanism came to public attention in Pennsylvania and Texas.

In Pennsylvania the procedure is called "ghost voting." This year a Pennsylvania representative was recorded as voting for the budget on a key vote. It was recorded while, by his admission, he was in the Philadelphia Airport, not the capitol at Harrisburg.

The Texas situation concerns the votes of a representative who was not present because, as discovered later, he was dead in his apartment. Under Texas house rules, a member can vote on behalf of another if (1) there has been a specific authorization by the member and (2) the non-voter is present in the House chamber or an adjacent room.

A group called the Pennsylvania Leadership Council is threatening litigation in Pennsylvania. Such challenges normally fail. The courts are reluctant to overturn a decision taken by a legislative body and certified by its presiding officer as an enrolled bill. This is particularly the case when no objection was made at the time of the vote. In Pennsylvania, the leading case was a challenge to a legislative pay raise bill passed in the early 1970s by the deciding vote of a legislator on a cruise in Scandinavia.

Tax Increases: Who raised taxes this year, how much? Answers are starting to appear in various surveys, but the subject is controversial in some states and has difficult conceptual problems. In Georgia, the sales tax was scheduled to come off some food items, but a judicial decision blocked the change and elected officials endorsed the judicial decision. In Massachusetts, the new sales tax on services went into effect for a day or so and was repealed. In Indiana, the motor vehicle excise tax went down in the first half of the year but was then restored to its former levels. In Indiana, Kansas, Texas, and other states, the state school aid formula effectively mandates local property tax increases.

The fiscal survey NCSL released in August has apparently moved to a policy of considering an unchanged state tax policy to be an increase if a change was scheduled. So it reports that Louisiana and Illinois raised taxes by more than 5%. Taxpayers in these states won't notice any major change in their taxes. Existing levies were simply extended.

TECHNICAL NOTES

Employment: Employment data shown in Table 3 and used in the Index of State Economic Momentum reflect primary data generated by employers and reported in connection with Unemployment Insurance taxes. Because of the tie to tax administration, the data are highly reliable. However, they include employees twice if they hold two jobs. For large states and national totals, the Bureau of Labor Statistics has another method relying on household surveys. These data don't double count, but are less reliable for large states and unavailable for most states. For many state purposes, including economic development and revenue estimating, the second job is relevant. For example, loss of a second job does affect state revenues and state economic opportunity even though it doesn't result in unemployment.

Reports doesn't use unemployment rates as an indicator for several reasons. First, the structures of state economies create consistent differences. Farm states have consistently lower rates than industrial states. States with widespread supplemental benefit programs like those of the auto and steel industries have consistently high rates. Second, the denominator for unemployment is those actively seeking work. When an economy sours, some people ("discouraged workers") stop looking for work and lower their state's unemployment rate.

State And Local Tax Revenues: The data in Table 5 and on components of personal income come from the National Income and Product Accounts estimates appearing in the Survey Of Current Business (August). Median home price data in Table 6 come from the National Association of Realtors. The permits data are collected by the Commerce Department and packaged in usable form by the National Association of Home Builders in Housing Economics (August). State revenue data are from the Census Bureau Quarterly Summary Of Federal, State, and Local Tax Revenue: January-March 1991 and Center for the Study of The States (State University of New York at Albany) State Revenue Reports (August). Table 7 relies on the Census reports.

Insurance: For interesting journalistic accounts of the problems and accomplishments of the new California insurance commissioner John Garamendi see "Insurance Chief Achieves Fame Amid Failures," Wall Street Journal (5/17) and "Fast Start Through The Insurance Minefield," California Journal (July).

Pension Plans: Examples of the coverage of the California issues will be found in USA Today (7/3), the Wall Street Journal (6/18 and 6/20), the New York Times (6/18), the Washington Post (6/18), and Business Week (7/1). Regan's views are summarized in the Wall Street Journal (9/13). Statistics on public pension plans are published quarterly by the Census Bureau in Finances Of Selected Public Employee Retirement Systems. The latest release was in September covering the quarter ending in December of 1990.

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STATE POLICY REPORTS

VOLUME 9 ISSUE 19

The property tax is the least favorite tax of voters and elected officials. Yet its role is secure and its revenues are rising faster than other taxes. One reason is that the tax looks better when the alternatives are considered than when viewed in the abstract. Over the past decade, some states have substantially reduced property tax burdens but other states have increased them.

o Property Taxes p. 2

State officials are finding that it is difficult to consider the finances of state governments separately from those of local governments. Current issues in Maryland and New York illustrate the interactions. Helping Baltimore and New York City is an objective, but avoiding clear redistribution from the suburbs is a consideration.

o State And Local Fiscal Relations p. 11

State budgets have assumed stable federal policies and the spending levels reflected in last year's budget compromise. Despite recognition that the deficit will be larger than assumed and the Soviet military threat less than assumed, stable federal funding looks likely.

o Federal Policy And Grants p. 13

The state financial outlook is currently uncertain, primarily because the national economic outlook is uncertain. Risks to balanced budgets include health care and litigation. In the few gubernatorial elections this year, finances aren't a major issue.

o State Finances p. 15

Miscellany covers electronic funds transfer, measuring state exports, insurance regulation, kudos, pension benefits, public opinion, tax and spending limits, tax litigation, and Workers' Compensation. Technical notes detail data sources.

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PROPERTY TAXES

Introduction, The Unpopular Tax: The property tax, as shown by an ACIR survey described in this issue, remains about the least popular tax. Elected officials often campaign on their concern about property tax burdens and their promises to do something about them. Many states have limited local property taxes for decades. A new wave of limitations began over a decade ago with Proposition 13 in California and Proposition 2 1/2 in Massachusetts. Many states have clones of these measures. Oregon's new Proposition 5 requires a gradual reduction of property taxes that is so massive that replacement revenue from the state is likely.

Property tax limits were active issues in some states this year. In Illinois, Governor Edgar successfully encouraged the legislature to adopt a limit for the suburban counties around Chicago. In Michigan, the governor (R) and legislative leaders (D) both offered competing limit proposals. Taking pressure off property taxes is one of the rationales for raising state taxes for public schools. This, combined with educational quality concerns, was associated with the tax passed by the Arkansas legislature this year, the popular vote in November on the tax increase adopted by the Missouri legislature, and the referendum this year on repealing the tax measure passed in Oklahoma last year. The New Jersey tax increases of 1990 were associated with property tax relief, school finance, and fiscal relief to distressed communities. This year some of the school money was reallocated to property tax relief in response to adverse voter reaction.

Yet The Popular Tax: Despite all this voter and elected official antipathy, the role of the property tax in government finance is increasing in many states. Higher property taxes are a consequence of cutbacks in state aid for local governments. They are often mandated by changes in school aid equalization formulas. The result of these changes is now, for example, beginning to appear in property tax bills in Kansas and Texas.

The property tax is often an easy tax to raise. Through the 1980s, values of existing properties rose more rapidly than inflation. These increases are, often with a lag, reflected in assessed values. In addition, the total assessed value was enhanced by new residential, commercial, and industrial construction. The standard limits on property taxes apply to rates, not to the tax base, so local officials found it relatively easy to capture 5-12% increases in revenues without raising rates and without bumping into limits.

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The result can be seen in the different rates of increase of the major state and local taxes as shown in Table 1.

Table 1: Relative Reliance On Three Major Taxes ($ billions)

Type Of Tax	CY1989 Revenue	CY1990 Revenue	Percent Change
Personal Income	$101.7	$106.2	4.4%
Sales	170.9	181.4	6.1%
Property	139.9	150.1	7.3%
Total, Three Taxes	412.5	437.7	6.1%

These current estimates (from the National Income and Product Accounts) suggest that if popularity is measured by increases in amounts raised, the property tax is the most popular tax, not the least popular.

Assessed Value Increases: Assessed value increases, not tax rate increases, are the key to increasing property tax yields in most jurisdictions most of the time.

Massachusetts local governments provide an example as they coped with a sharp downturn in the state's economy and declining state aid while limited in their use of property taxes by Proposition 2 1/2. It draws its name from what is often understood as a limit of 2.5% on property tax increases.

In 1990, Massachusetts local governments saw a cut of 8.5% in their state aid, which is about a fourth of their budgets. They nonetheless managed a 4.7% increase in spending by relying on an 8.3% increase in their property taxes and an 18% increase in fees and charges. In their 1991 budgets, they are increasing spending by 4.8% despite only a 3.5% increase in fees and a 5.3% additional cut in state aid. The key is a property tax increase of 7.5%. The property tax increases are primarily the result of added assessed value from new construction added to the rolcs, though there have been voter overrides of the Proposition 2 1/2 limits in some smaller communities.

Michigan and Wisconsin illustrate the inflation-beating changes in assessed values in the late 1980s. Both states lagged the nation in economic growth in that period, but showed changes in assessed values well above the 4-5% inflation rate. Residential property accounts for about 60% of total property values in Michigan and 62% in Wisconsin. Table 2 shows the annual changes.

Residential property values in Michigan have increased by nearly 10% in the last two years for which information is available. Other valuations, such as commercial and industrial, didn't rise as rapidly. Nonetheless, Michigan local governments could have increased their property tax revenues over 8% annually in the last two years with no increase in tax rates. In Wisconsin, the growth in the property tax base is slightly less dramatic, but still in excess of inflation. This is a major reason why holding down local property tax burdens is a major issue in both states.

Table 2: Percentage Change In Assessed Values, Michigan and Wisconsin

Year	Michigan Residential	Wisconsin Residential	Michigan Total	Wisconsin Total
1987	5.0%	2.8%	4.6%	1.0%
1988	8.1	4.5	7.2	3.9
1989	9.6	5.8	8.2	5.2
1990	9.9	6.8	8.8	6.1
1991	--	7.7	--	6.7

Assessed Value And Rates: Much of the politically salient excitement about property taxes is concentrated in situations where something unusual occurs. Increases of taxes on residential parcels in the 5-10% range aren't generally the source of tax limit movements. One such unusual event is the sudden jump in assessed values that result when there is a reappraisal after a long period of no reappraisals. This is the source of constant agitation in Cook County (Chicago and near suburbs) and of current controversy in the Atlanta area. In Georgia, as in some other states, taxpayers are notified of appraisal changes but don't know what their tax bill changes will be. The tax bills are set only after the total assessed value is known. So taxpayers may find themselves with a notification that their assessed value is up by, say, 50% and be told that their taxes won't go up 50%. However, no one knows how much they will go up.

The experience of many New England taxpayers is captured in the taxation of President Bush's home in Kennebunkport, Maine. In 1989, the First Family paid a property tax of 1.96% on an assessed value of $891,600. For 1990 taxes, their home was reassessed to a new value of $2.2 million, a whopping 146% increase. Not to worry, cautioned local officials, the tax rate will go down. It did, to 1.14%. That made the new tax bill $25,500, a tax increase of 28.5%.

Property Tax Approaches In 1991: Writing in State Legislatures (May) on "Easing The Pain Of The Property Tax" before most states had completed their legislative sessions, NCSL staffer Scott Mackey observed:

> As property taxes increase, so does the likelihood of property tax revolts like the one in Oregon. Lawmakers seeking to avoid them may be forced to raise other taxes to provide property tax relief to the middle class.

The jury is out on whether lawmakers in other states are willing to raise state taxes in order to reduce local property taxes.

Precise measurement of the impact of state budget decisions on local property taxes is difficult, if not impossible, even well after the fact. Local officials like to attribute their tax increases to state action or inaction. State elected officials like to attribute local tax decisions to local officials, even when they clearly aren't local, as in the case of the minimum property tax levy to receive state school aid. There is no referee for the competing claims. But in many states, the impact of the state action and inaction is clear. The results suggest no particular tendency in state policy.

State Taxes Relieving Local Fiscal Pressures: A few of the tax increases are likely to relieve pressures on local taxes even if not intended to produce that result. Examples are the school tax increases in Arkansas and Missouri and the new Connecticut income tax.

In other cases, the state relief isn't as dramatic, but state decisions will at least maintain funding levels, including inflation adjustments, for local activities. Local officials, however, won't necessarily see it this way. An example is California, where new local revenue accompanies responsibilities shifted to local government, and school funding is maintained at Proposition 98 levels, guaranteeing adjustments for enrollment and inflation. Vermont's large tax increase was designed to avoid sharp cutbacks that would otherwise have been necessary in many programs including local aid.

State Cutbacks Increasing Local Fiscal Pressures: Most of the states have put major pressures on their local governments, including school districts. In the Southeast, the cutbacks, which are continuing in FY 1992, were generally made administratively. The Alabama school cut, known as proration, is automatic. In North Carolina and Virginia, among others, decisions had to be made about how to allocate the cuts in FY 1991 enacted budgets and in FY 1992. Since the FY 1992 budgets were adopted, there have been major cuts announced in Florida, Georgia, and Maryland.

In the tight budgets of Midwestern states like Illinois, Indiana, Iowa, Michigan, and Minnesota, there was essentially no new funding for local governments except small increases in school aid. Many of the relatively autonomous local governments in these states will respond with higher taxes.

The most dramatic pressures on local taxes will appear in Massachusetts and, to a lesser degree, New York. Both have extensive local aid programs beyond their support of public schools. Both avoided large tax increases by cutting some of these programs below the level of prior years and providing no growth in others. These and the equalization states (see box) will likely see the most rapid property tax increases.

How Equalization Raises Property Taxes: The essence of school finance equalization is to cause per pupil spending among districts to be more equal, assuming equal local tax rates. The most expensive way to do this is by adding state aid to districts with the lowest tax base, but the costs of sole reliance on this method have been too much for every legislature. So some tax base must be taken away from richer districts and, in effect, redistributed to poorer ones.

There are lots of ways to do this. With tax base sharing -- long in effect in the Minneapolis area and newly adopted in Michigan -- some tax base is shared regionally. In Texas, new taxing districts combine formerly rich and formerly poor school districts for property tax purposes. In most states, raising the local effort factor also achieves redistribution. That factor is automatically increased more for rich districts than for poor ones because it depends on the size of the local tax base. Because the factor is a deduction from school aid that would otherwise be paid, raising it cuts the aid most for the most affluent districts.

No matter how the wealth is redistributed, it results in more school spending in the poor districts. It will produce less spending in the affluent districts, unless something is done. The state may not cushion this effect completely through increased aid. The result, now causing considerable concern in Dallas area school districts, is some combination of program cutbacks and higher local property tax rates.

Special Forms Of Property Tax Relief: Many states have property tax relief programs. They come in several distinct forms with differing effects.

Simple limits on property taxes with no replacement revenue from the state are common. Proposition 13 in California and the new Illinois limits are examples. Many issues associated with these limits are unique to each state and limit. In California, there is constant litigation over what kinds of revenue-raising measures are exempt. In Illinois, there was controversy this summer over a rush of local borrowing designed to get the resulting property tax for debt service into the base before the limits on increases went into effect. In Massachusetts, there is controversy over details of Proposition 2 1/2 enforcement. Concerned with the impact of state cutbacks on local finances, the legislature loosened some restrictions. Concerned with taking the property tax decisions from the voters and putting them in the hands of local elected officials, the governor vetoed the bill.

A recent study compared property tax changes in states with limits of various types and without limits. It suggests that some forms of limits, particularly those controlling both assessed value and rates, have been effective in keeping property taxes lower than they would otherwise be. They also tend to hold down local revenues, but not as much as they hold down property taxes. Revenue raising pressures appear in other taxes or fees when property taxes are limited.

Some state decisions provide relief for one group of taxpayers at the expense of another by deviating from uniform tax rates. One method is the classification of property so that, for example, residential property pays a different rate than commercial property. This usually occurs by having assessments of different classes of property be differing percentages of market values.

Classification issues dominated the statewide elections in Kansas in 1990 and remain a knotty problem. Legislators there, as elsewhere, constantly rediscover that they can't help one group of property taxpayers without increasing taxes on another. The issues often interact with state constitutional provisions and the federal "4-R" legislation barring discrimination against certain forms of transportation. The result can be a complex and nearly intractable mess, which describes what Nebraska legislators faced this year. Another form of relief comes by exempting a portion of assessed value from property taxes through homestead exemptions. There was considerable discussion of this topic this year in several states, but little action.

There are also special provisions of state income tax laws that are designed to offer property tax relief. One is circuit breakers which offer targeted relief. The targets are the elderly and/or low income persons with relief in the form of tax credits generally based on the extent to which property taxes exceed a stipulated percentage of income. Broader relief is offered by a few states in the form of special decisions in the state income tax for property taxes paid. New Jersey eliminated one of these in its 1990 reform package. Illinois converted its special deduction to a more restrictive credit in this year's action.

Who Pays Property Taxes? There is general agreement among tax analysts that residential property taxes are regressive, representing a higher proportion of income for low income taxpayers than for higher income tax payers. A typical study result was presented at a Maryland tax policy conference earlier this year. Estimates for the three major taxes are shown on Table 3. While calculated from 1987 data, they should approximate 1991 burdens.

Table 3: Maryland State And Local Taxes As Percentage Of Income

Income Class	Property	Income	Sales
0-5,000	9.4%	0.8%	11.2%
5,000-10,000	2.8	1.7	4.1
10,000-15,000	3.1	2.9	3.7
15,000-20,000	3.0	4.2	3.2
20,000-30,000	2.9	4.4	2.8
30,000-40,000	2.7	4.4	2.6
Over 50,000	2.1	4.4	2.0

The simple reason why lower income people find property taxes a higher proportion of their income than higher income people is that they spend a higher percentage of their income on housing. However, the regressivity may not be quite as serious as some studies suggest.

Property Tax Revolt? While the property tax is widely disliked, there don't appear to be nationwide signs of a property tax revolt comparable to the wave of initiatives and legislative actions that followed Proposition 13 over a decade ago.

One major reason is that property tax burdens, on average, haven't been increasing. In the 1960s, property taxes took around 4% of personal income, which rose to 4.4% in 1972. They had dropped to just over 3% by 1982 and remain there today.

Another major reason is that many voters don't have a method for translating concern over property taxes into a statewide policy because they don't have access to initiative and referendum. Michigan and Oregon show the contrasts. Both states rely heavily on property taxes for schools. In both states, experts, teachers and other school personnel, and most elected officials of both parties view higher reliance on the sales tax and lower property taxes as appropriate state policy. In both states, property taxes are high as is voter resentment of property taxes. In both states, voter resistance to property tax levies is high in local elections. In both states, state leaders have presented propositions to the voters that promised lower property taxes at the price of sales tax increases (Michigan) or adopting a sales tax (Oregon). In both states, voters have rejected these measures.

There the resemblance between the two states ends. Michigan officials continue to seek to outpromise each other with property tax relief plans, but there has been little change. With initiative a popular mechanism for many purposes, Oregon voters adopted a property tax limit and a mandate that the state raise the revenue that local governments will lose. The net effect will presumably be, sooner or later, a new Oregon sales tax.

High Property Tax States: There are several answers to the question of which states have the highest property taxes. Each of the relevant concepts is used to rank states in States In Profile: property tax revenue as percentage of revenue from the three major taxes (Table D-3), per capita property taxes (Table D-7), property taxes in relation to personal income (Table D-9), and property tax burden under the representative tax system (Table D-21).

In the latest year for which data are available (FY 1989), property taxes ranged from 6.6% of income to 1.2% with a national average of 3.5%. Each of the highest ten states has its own property tax story, but there are some common themes. The two states with the highest burden -- Alaska (1) and Wyoming (2) -- get their rankings from taxes on resource industries, particularly oil and gas. There is little pressure for change. New Hampshire (3) has high property taxes despite low public spending because it doesn't use sales or income taxes. Residential property taxes are particularly burdensome for long-time low income residents whose property values rose with the state's prosperity while their income didn't. Relief targeted to them is difficult because the only source of funding is yet higher property taxes for other Granite State property owners. This leads to pressures for an income or sales tax in New Hampshire. For the same reason, the solution to high property taxes is seen as adopting a sales tax in Oregon (4) and Montana (5).

Many other states with high property tax burdens in FY 1989 have taken action to reduce pressures on property tax funding. Vermont (6) raised practically every state tax this year. New York (7) raised state taxes in 1990 and 1991, but not enough to avoid property tax increases in New York City and in suburban counties. New Jersey (8) increased sales and income taxes in 1990 and provides state checks for property tax relief. Nebraska (9) passed a comprehensive package raising sales and income taxes explicitly to relieve property tax burdens. Michigan (10) hasn't acted, which is why property tax relief is a major issue there.

States Increasing Property Taxes: For taxpayers, the changes in property tax levels may be as important as the absolute levels of property taxes. The most appropriate measurement of change is probably to compare property taxes over time on an identical home. With these data unavailable, the closest proxies are changes in per capita property taxes and property taxes as a percentage of personal income. The comparison, which appears in Table 4 for selected states, combines taxes on residential, commercial, utility, and other property. Even though two states increased property tax burdens at the same rate, one may have increased residential property burdens much more than the other.

Table 4: Percent Change In Property Tax Burdens, FY 1979-1989

State	Per Capita	Percent Of Income
New Hampshire	148%	-6%
Virginia	143	6
Louisiana	138	28
South Carolina	134	15
Texas	123	16
Florida	122	1
Connecticut	120	-15
Oregon	117	16
Georgia	112	-6
Minnesota	112	0
New Jersey	109	-17
Wisconsin	105	-1
Alabama	104	0
California	104	-2
Michigan	103	4
Pennsylvania	103	-2
United States	**95**	**-8**
Arizona	70	-18
Delaware	67	-18
South Dakota	59	-14
Idaho	58	-14
Missouri	55	-26
New Mexico	37	-28
Massachusetts	36	-48
Nevada	9	-42

The percentage increases in per capita amounts don't have consistent relationships with the increases in amounts related to personal income because per capita income growth varied considerably among the states in the decade covered by the table. With rapid income growth, New Hampshire had the nation's leading increase in per capita property taxes but managed to reduce property taxes in relation to personal income. But the other states with high per capita increases show increases in the second column as well.

The Outlook: There doesn't appear to be a clear-cut trend among the states in dealing with property taxes. In terms of broad patterns of local finance, some states are continuing a trend of increasing the state share of total costs, raising state taxes as necessary to achieve this result. But other states have been curtailing local aid, a trend that may persist beyond the recession. State-funded local property tax relief also presents a mixed picture. Sometimes the picture is even mixed in a single state. Maine has adopted several relief measures over the past several years, but retreated from some in the face of fiscal adversity. One question is "Property Tax Relief Mechanisms: Should States Get Out Of The Business?" which Therese McGuire posed in the Government Finance Review (June). Her answer:

> There thus appears to be no magic solution to high property tax burdens. Each of the property tax relief mechanisms has its imperfections. The very concept of state involvement in the fiscal affairs of local governments is challenged here through an interpretation of economic models and evidence. As states continue to evaluate and reform their fiscal systems in the decade to come, the link between state and local governments provided by property tax relief mechanisms will be an important area of potential reform and change.

The property tax has few advocates among citizens, academics, or elected officials. Its popularity in practice is based on the fact that state and local officials often can't think of a better idea in their particular time and circumstances. The property tax is often also the "default" in public finance choices. For example, state officials agree with enthusiastic support of educators that the state share of public school costs should be increasing. The policy substitutes state income and sales tax revenue for local property tax revenue as well as leading to more spending. But when fiscal stringency and other priorities cause state aid to be cut or increase less than school spending increases, the role of the property tax increases by default.

Sharply diminishing the role of the property tax isn't easy, as elected officials in Michigan and Oregon have found by taking propositions to voters to increase sales taxes in order to reduce property taxes. Abolishing the property tax entirely raises a host of difficult problems, as the British discovered when they substituted a per capita community charge (which critics call a poll tax) for their local property taxes. The change has been unpopular since being introduced last year. This spring the system was changed by reducing the community charge and making up the revenue by increasing the value added tax and certain excise taxes. A new system reinstating property as part of the tax base is expected to be announced before nationwide elections, which must take place before next summer.

If property taxes are to remain the mainstay of local government finance, state officials may get more serious about the state-controlled procedures determining property tax administration. There is a substantial reform agenda with little dispute among experts on what the agenda contains and plenty of states following apparent best practices. A recent report in Indiana indicates the kinds of changes that can be made. An example is providing a reasonable number of separate officials to control assessments. Some states make the function a county one so California has 58 jurisdictions involved, Florida and Pennsylvania have 67, and Ohio has 88. But less populous Indiana has 1,008 -- lots but not as many as North Dakota with 1,721 and Wisconsin with 1,837.

STATE AND LOCAL FISCAL RELATIONS

Fiscal Realignment In New York: Concern about state-local finances in New York has an urgency not present in most states because of the seriousness of the problems and thus their tendency to reappear frequently. The underlying problem is that state and local spending is well above the national average while personal income isn't. This means that tax burdens are high, so high that there is greater than normal reluctance to raise taxes, state or local. As a result, it is more difficult for the state to deal with central city problems by absorbing functions or costs than in most other states. Conversely, there are greater limits on the state's ability to solve its fiscal problems by pushing them to local governments than in some other states.

In this context, state and city officials haven't found dramatic solutions for the impact of the economic downturn on the state and particularly on New York City. This year the state cut some of its local aid and raised taxes. New York City announced various austerity measures, not all implemented, and raised its taxes. The city's long term fiscal plan calls for further increases in taxes, including property taxes. Key city business leaders have been calling for more austerity and a four-year moratorium on city tax increases.

Splitting Medicaid costs with the state is one New York City burden not carried by other major cities, even the ones that like New York have county as well as municipal functions. There has long been interest in shifting these costs to state government, as has occurred in most states. The principal barriers are the ones to shifting any local function to the states. First, the state can't afford it. Second, the fiscal relief afforded local areas would be much greater in some areas than others. In this case, suburban tax payments to the state would defray much of the cost while much of the fiscal relief would be concentrated in the cities. Recently the governor announced a long term plan for dealing with the situation. Medicaid costs would gradually shift to state government. So would local taxes to pay those costs. For New York City, this would presumably include a significant part of the local income tax. For at least a while, the state would be collecting higher income taxes in the city than elsewhere in New York.

Tax Policy And Fiscal Disparities In Maryland: Maryland's state-local fiscal relationships provide the same types of policy choices but are more easily understood because the state of 4.5 million people concentrates local responsibility in 23 counties and one independent city, Baltimore. These local governments carry responsibility for schools as well as major local functions.

Maryland has experienced the same fiscal problems as other East Coast states. A blue ribbon tax policy commission made its recommendations available for this year's legislative session. Unlike recommendations of most such groups, it did not suggest revenue neutral changes and offer suggestions for what tax to raise if the legislature opted to raise taxes. Instead, it recommended more spending and taxes, including specifying the amounts. The legislature opted to avoid major tax increases in its spring session. Now it appears that revenues are running well behind the estimates associated with the enacted budget. The governor has announced a series of austerity measures including laying off over a thousand employees, but hasn't implemented them until he completes discussions with legislative leaders. It's fairly obvious that, given his choice, the governor would like to see a substantial tax hike.

Maryland has the same types of grants to local government that are found in other states. It also has a unique piggyback local option income tax. All local governments have exercised the option which gives Maryland what amounts economically to a graduated personal income tax with one-third of the income going to the county of origin.

Part of the research done for the commission was a study of the spending needs and tax base of the counties. Done by the Advisory Commission on Intergovernmental Relations, it reflects ACIR's concepts of representative tax and expenditure systems for states, only applied at the local level. The results are expressed as a percentage of the statewide average in Table 5.

Table 5: Fiscal Capacity and Need Of Selected Maryland Counties, 1988

Type Of Jurisdiction	Tax Capacity	Needs	Net Local	Net w/ Grants
Industrial Enclave (Calvert)	166	92	181	154
Affluent Suburb (Montgomery)	156	88	178	144
Statewide Average	**100**	**100**	**100**	**100**
Poor Rural (Allegany)	71	100	71	86
Central City (Baltimore)	57	142	40	69

The first column shows the wide variation in tax base with Baltimore having only 57% of the state average. The second column shows the disparities in "needs" measured by such factors as the percentage of population in poverty and number of public school students. The affluent suburb has needs relatively close to, but below, the statewide average while Baltimore exceeds the average by 42%. The third column relates the first two. One way of looking at it is to conclude that the suburban county is 81% better off fiscally than the state average while Baltimore is 60% below average. The fourth column is another version of the third column, adjusted to reflect the impact of federal and state grants. The grants (including federal programs phased down or out since 1988 when the data were collected) reduced the disparities, but clearly didn't eliminate them. State grants subtracted 19 points from the tax base of the suburb, 16 from the enclave, but added 9 points to the poor rural county and 20 points to Baltimore.

The difficulty for Maryland legislators is to coordinate their tax policy adjustments with their state-local fiscal adjustments while producing a package that is feasible to enact. Raising the income tax would produce much more piggyback revenue for the affluent communities than elsewhere. But a solution that broke the piggyback link for the added increment of tax would make clear that much of its revenue would be raised in some counties to be redistributed to others. The school aid formula can also play a role in shifting purchasing power, but there are hazards. Many of the adjustments in school aid (e.g., putting teacher retirement in the school formula rather than paying it separately) are the types of changes enacted in New Jersey in 1990 and reconsidered in 1991 after strong opposition appeared.

FEDERAL POLICY AND GRANTS

Federal Grant Appropriations: The Congress failed to enact appropriations for many programs before the October 1 beginning of the federal fiscal year. This doesn't matter much as continuing resolutions will provide interim funding. There is little controversy over appropriations for grants, so last minute surprises upsetting state budget planning are unlikely except for Medicaid bootstrap financing regulations.

Led by Medicaid, set to grow 16.2% in FY 1992 in both House and Senate legislation, federal aid is likely to grow by over 10%. This is well in excess of the growth rate in state and local tax collections and well in excess of likely inflation.

Federal Deficit: The budget compromise legislation from last year will result in much larger deficits than contemplated when it was passed because of the economic downturn and various misestimates. The resulting deficit in FY 1992 will add over $1,000 per capita to the federal debt. This doesn't seem to be a cause for widespread concern inside the Beltway. As a result, the outlays contemplated by the compromise, those assumed in state budgets, are likely to be made. FFIS (see Technical Notes) suggests that neither party is interested in amending the basic budget legislation until after the 1992 elections, so "it is therefore expected that smoke and mirrors will be employed to a fairly significant extent in the 1993 budget."

There is one problem. The legislation was designed to provide enough borrowing authority (debt ceiling) to get through the 1992 elections without voting more. But higher deficits mean more borrowing, perhaps so much more that debt ceiling legislation will be required. Votes on that legislation usually produce debates and amendments on the budget process and sometimes on overall spending levels.

The debt limit debate could provide an occasion for cutting the federal programs on which state budgets depend. On the other hand, the argument is being made that changes in the international situation and Soviet military capabilities and intentions permit a sharp contraction of the defense budget. Opening the budget agreement with that logic would turn the debate to higher federal domestic spending in such areas as education and health care.

Funding Formulas: The federal Medicaid formula will be allocating about $80 billion among the states in FY 1993 for Medicaid,. AFDC welfare assistance, and child care. The formula governs only the sharing of costs between the states and the federal government. The states determine how much is spent in total, within guidelines that aren't very restrictive and state budget constraints that are. The formula is applied to that total cost.

By using the square of per capita income to magnify disparities among states, the formula is designed to: (1) provide much larger federal shares to poor states than more affluent ones and (2) adjust automatically to changing fortunes of individual state economies. Without any other factors, the formula would provide a federal match of 15% of Connecticut's costs and 20% of New Jerseys, on the low end, while covering 79% of cost in Mississippi and 76% in West Virginia. However, there is a 50% minimum federal share.

New per capita income data will affect the FY 1993 percentages. Large gainers are states where the 1990 Census sharply upped population estimates and thus dropped per capita income estimates. The biggest gainer is Arizona, where 3.3% of total Medicaid will shift from state to federal funding. There will be lower federal shares for 29 states led by Nebraska and Hawaii.

Despite matching percentages favoring poorer states, more affluent states typically get the largest per capita Medicaid payments because those states have larger and more costly programs. They typically have more generous eligibility criteria, cover more services, and have higher reimbursement rates for doctors and hospitals.

STATE FINANCES

Fiscal Conditions: The state fiscal outlook remains in doubt as each month's tax collections, national economic statistics, and forecasters' shifting views are examined to see where each stands.

The situation is considerably different than it was a year ago. Then just about every state was starting to get bad news as revenues were running below estimates. This year the estimates are more pessimistic and the economy isn't losing ground, or at least not as much ground as last year. As a result, the relationship between estimates and actual collections isn't the shortfall of last year but a combination of shortfalls and surpluses on a month to month basis. The situation of each state depends on: (1) how optimistic/pessimistic the revenue estimates are and (2) how well/poorly that state's economy is performing relative to the national economy. Uncertainty is the overriding characteristic of state views of the fiscal outlook.

There is no uncertainty about FY 1991 which ended in June for most states. The returns are in and weren't good. This means states have ground to make up in FY 1992 that wasn't expected when the FY 1992 budgets were enacted. The mechanisms are complex, but making up for FY 1991 shortfalls will have the first call on any unexpected revenue in FY 1992. Also, the budget assumptions of many states are being challenged by the potential federal regulations on Medicaid bootstrap financing. If the regulations go into effect as scheduled, they are bound to result in added demands on budgets of the affected states. Some will probably react by substituting new taxes on health care that are consistent with the regulations for special taxes and donations that aren't consistent.

Data are insufficient to suggest a median situation for states that raised taxes, but **Reports** suspects North Carolina, whose situation was recently estimated by the legislative fiscal office, may be it. Collections for the first two months of the fiscal year were slightly over estimates. But to deal with FY 1991 problems, some refunds weren't made until FY 1992. Combining the good news on current collections with the bad news from the prior year, revenues are "essentially on target." The assumed growth in FY 1992 revenues is 4.5%, well below the 7.5% that represents normal growth. This means that the state should be able to operate in the black even with a slow and weak national economic recovery.

The outlook is much tighter for the states that didn't raise taxes. They had less cushion to absorb the FY 1991 year-end revenue shortfalls. They probably left less room for error in their FY 1992 revenue and spending estimates. The results are special legislative sessions to cut spending (e.g., Georgia and Maryland), administrative cuts (Florida and Iowa) and consideration of major changes that haven't yet resulted in action (Colorado and Tennessee).

Also worth remembering: many states left loose ends in their FY 1992 budget action. Examples are employee compensation in California and Connecticut and health insurance and general assistance in Massachusetts.

As a result, there is considerable potential for late 1991 and especially early 1992 to present many state fiscal situations nearly as bad as those of 1991. The serious problems would be concentrated in the states that didn't make major fiscal revisions in 1991 by tax increases and spending cuts. But the reverse possibility shouldn't be ignored. The North Carolina analysis reminds readers of the rapid growth that followed the last recession. The growth forecasted for FY 1984 was 8%, but the state realized 12% growth because of the rapid recovery. A recovery of that magnitude might even revive consideration of tax cuts -- the forgotten topic of state finances -- in at least a few states.

Elections: Most states hold statewide elections in even-numbered years. The few exceptions with elections this year won't shed any light on tax policy, spending levels and priorities, economic regulation and other money issues of state policy.

The Mississippi race pits Governor Mabus against a Republican challenger. The big news the transition to a two-party situation, rather than having the choice be among Democrats. Mabus continues to take the positions he has for years. Elementary and secondary education is the key to the state's development, but must be funded without new taxes. This means a lottery, oft rejected by the legislature, and unspecified other non-tax revenue measures. His opponent is pro-development and anti-tax, without much detail.

In Kentucky, Governor Wilkinson can't run again. With the state still absorbing the complete rewrite of its education and tax laws of several years ago, the candidates are also pro-education and anti-tax without much detail. They do have details on tax burdens they would like to eliminate. For both, this includes the income tax on private pension income and the inheritance tax (presumably excepting the portion that has an offsetting credit against federal tax). Both have ideas that reduce the burden of the severance tax on coal.

The Louisiana race has received the most national coverage because of the personalities involved. Former Governor Edwards lost to Governor Roemer in the 1987 primary when both were running as Democrats. Edwards falls in the tradition of Louisiana populists including a strong political base among the poor and a flamboyant personal lifestyle -- many indictments but no convictions, love of gambling, colorful language.

Roemer came from his Congressional seat into a 1987 campaign that caught national attention because of self-imposed limits on campaign contributions, a determination to clean up state politics, and a technocratic-yuppie style that appealed to the nation's journalists. Early in his term, he pushed a variety of reform measures including a major tax reform package and extensive solutions to the state's then-serious fiscal problems. The tax reform included greater reliance on taxes on individuals (particularly income and property taxes) and less reliance on business taxes. The overall thrust of the plan was defeated -- in part by the legislature and in part by voters dealing with parts requiring constitutional amendment. Instead, the sales tax was extended to food and utilities. This solved the state's fiscal problem but left the tax system more regressive than before reform was proposed.

Roemer switched affiliation to the Republican Party, but the state party machinery didn't switch to him. It endorsed U.S. Representative Clyde Holloway. But the President and other national Republicans are backed Roemer. Then there is David Duke, who is viewed by the national media as standing for racial resentment. He is also a Republican. The October 19 primary narrowed the field to Duke and Edwards.

The common characteristic of all three races is the absence of discussion and debate oriented to fiscal issues.

Paying For Health Care: Federal action that might relieve state health care financing problems won't be forthcoming soon. In a recent Congressional hearing, Bush Administration officials were critical of a variety of proposals, but didn't offer one of their own. Budget Director Darmon talked of the possibility of a signing ceremony for a plan, but only in President Bush's second term. This would mean mid-1983 at the earliest. House Ways and Means Chairman Rostenkowski also offered criticisms of pending proposals.

Meanwhile, Medicaid costs are increasing by 15-20% a year with no relief in sight. The elements affecting cost per recipient are: (1) the unit prices prevailing in health care, which are rising faster than inflation, and (2) the units of care provided, which are a function of medical technology and medical practice which continue to evolve in the direction of more tests and more procedures. The number of recipients has some built-in long term growth because of increasing numbers of persons needing nursing home care and because of federal mandates regarding children and low income persons also receiving Medicare. The most positive possibility is that an improving economy might take some people off welfare, and thus off Medicaid.

California's situation, as recently portrayed by the Commission on State Finance, is indicative of the situation nationwide. Adjusted for accounting system changes, Medi-Cal will cost $4.7 billion this fiscal year, an increase of 17% over FY 1991. About 7% of the cost increase is associated with an increase in the number of recipients and 10% with an increase in the cost per recipient. The Golden State is moving to managed care though more slowly than New York which is moving as rapidly as it can to associate every Medicaid recipient with a primary care provider who determines the need for other services.

The Commission identified problems that could cause FY 1992 spending to be higher than appropriations. One category, found in many states, is savings from reforms that will not appear. In California this year they are: (1) a family planning program not likely to help much in FY 1992 because the babies affecting the fiscal year health costs will have been conceived before the program reaches and mothers and (2) a plan for recipients to charge fees of 50 cents to $3 as copayments. The legislature eliminated the copayment requirement from the budget legislation, but didn't eliminate the savings.

The Commission identifies "program pressures" that could cause overruns in FY 1992 totalling $1.14 billion or 20% of the Medicaid budget. One is federal disallowance of Medicaid bootstrap financing, where California is at less risk than some other states. The second comes from nursing home regulations adopted in the 1987 federal budget legislation. California has been in a dispute with federal officials on this topic with early estimates of state costs of $300-400 million. The Commission scaled down its estimate of risk to $100 million, over and above the $14 million included for this purpose in the budget legislation. Finally, there is litigation on reimbursement rates for hospitals and other providers. Following a U.S. Supreme Court decision that providers could sue and the July victory by hospitals in an action against the State of Washington, the California Association of Hospitals and Health Systems sued the state. The Commission estimates $100 million of risk to the Medicaid budget in FY 1992 (more in later years) and comments.

> If decided against the state, this suit could require substantially higher reimbursement rates for outpatient services. Moreover, the ruling could set a precedent for other Medi-Cal providers, such as physicians and laboratories, to file suit for higher rates as well.

Judicial Budgets: The chief justice of the New York supreme court announced he was beginning litigation against the governor (and presumably the legislature). The judge's complaint isn't unusual. He doesn't like the budget for the court system, which is producing about 500 layoffs in the lower courts that he expects will exacerbate backlogs in the judicial system and further encourage the use of plea bargains in criminal cases. The courts are not the only public agencies to complain about their budgets, but the only one to sue. The governor and legislative leaders of both parties responded that they thought the courts had been adequately funded. The governor's initial comment was, "First I'm going to laugh, then I'm going to take it seriously." Experience in other states suggests the governor is right in both reactions.

State constitutions, including New York's, clearly contemplate that no agency shall be able to spend public funds except pursuant to appropriations made by the legislature. This concept doesn't have any exceptions -- not for governors, not for the courts, not even for the legislature itself. The idea that the judiciary would set its own budget by litigation that it would both bring and decide smacks of irregularity.

But there are precedents. The chief justice counts 14 other states which have had such cases, with the result being orders for higher appropriations in some. The most compelling cases arise when the legislature provides no appropriation at all for a function mentioned in the constitution, such as the salary of an elected treasurer or comptroller. The legal going gets tougher when the hassle is over the amount rather than the existence of an appropriation.

MISCELLANY

Electronic Funds Transfer: Electronic funds transfer is becoming common for individuals who use it when they have paychecks and Social Security checks deposited automatically, use bank automatic payment plans for utility and other bills, and use debit cards like those that come with brokerage firms' cash management accounts. States use it in their employer role, in investment and cash management transactions of treasury and pension funds, and probably elsewhere. Experiments are under way to use the procedure for cash welfare payments. Other things being equal, the procedure saves considerable paperwork, and thus cost, associated with use of paper checks.

Other things are not equal when substantial "float" is involved. For example, when a tax payment is due on the 15th of the month, payment by check will not result in a cash outlay by the taxpayer until the 17th to 19th. Symmetrically, the state doesn't get the use of the money until those dates. In that context, requiring electronic funds transfer means cash on the 15th, thereby accelerating the receipt to the state and effectively accelerating the due date of the tax. For this reason, shifting to electronic transfer has revenue effects. An increasing number of states are shifting to EFT as indicated by a survey of state tax agencies.

Exports: Stimulating exports is a key part of the economic development strategy of practically every state. The obvious test of these programs is whether exports are increased. But measuring exports isn't easy. A recent study assesses the two available measures and finds they produce quite different results. For example, one measure makes California exports 32% higher than the other while Connecticut exports are shown to be 35% lower. For smaller states, such as Nevada and Wyoming, one series estimates exports twice as high, or more, than the other. The ideal solution, according to the Federal Reserve Bank economist who did the study, is a third series that would measure value added in each state.

Insurance: The well-publicized insurance company failures seem to be producing more nationally uniform regulation of insurers and guarantee funds, though how the system will evolve is in doubt. Some Members of Congress are pushing federal regulation, but their criticisms of state regulatory failures are getting more publicity than votes. The state regulators and most of the industry are opposed. With the bad news about federal regulation of banks and S&Ls continuing, some are skeptical about turning insurance regulation over to the federal government.

State regulators and the industry are attempting to clean up their act. The National Association of Insurance Commissioners has model legislation and is considering other actions such as multi-state guarantee funds. There are extensive efforts to combine state guarantee funds and private company investments to resolve the situation of failed Executive Life policyholders.

Kudos: Governor Wilson's handling of California budget problems has been reviewed by many newspapers and magazines, typified by the Wall Street Journal (9/20). The governor gets credit for a fiscally successful resolution of a difficult budget problem with a budget the Journal called "a model of balance and political acuity." However, national observers predict problems ahead. Some are political, as the budget solution alienated many conservatives with its heavy emphasis on tax increases. Some are non-fiscal issues to come. including subjects from gay rights to water policy. Less emphasized in the coverage is the evolving fiscal situation. The budget, like those of other states, presumes national economic recovery starting in July of 1991 and continuing through FY 1992. Longer term, California's ability to fund its current services depends upon the state maintaining the pattern of the 1980s with economic growth consistently about a percent above the rest of the nation.

Pension Plans: The National Conference of State Legislatures has recently completed a compilation of state pension plan provisions covering regular and state police employees. It shows the benefit formulas for each type of plan for each type of employee. Some representative benefit levels are shown in Table 6.

Table 6: Typical Pension Benefit, Employee With Identical Salary Histories, 1990

State	Regular	Police
California	17,078	17,078
Florida	12,506	15,633
Georgia	13,423	16,369
Illinois	14,041	20,280
Michigan	11,947	24,554
New Jersey	13,353	19,989
New York	13,273	19,989
Pennsylvania	15,991	21,348
Texas	15,991	19,989

Public Opinion: The Advisory Commission on Intergovernmental Relations has been sampling public opinion on fiscal issues for nearly 20 years. The newest survey shows little change in the last several years on key fiscal questions. When asked to identify "the worst tax -- that is, the least fair," 14% of respondents offered no opinion on which was worst. The big losers were the local property tax (30%) and the federal income tax (26%). The state sales tax drew 19% and the state income tax 12%.

Respondents were asked which level of government spends their tax dollars most wisely. Ten percent said they didn't know. A whopping 27% deviated from the suggested choices to say than none did and 2% volunteered that all did. Among the answers on the list, local government got 35% approval, followed by states with 14% and the federal government with 12%. An obvious inference from this result and the tax preferences is that state governments should use sales and income taxes to put money in the hands of local government to relieve pressures on the property tax.

Tax And Spending Limits: Many states have statutes or constitutional provisions designed to limit the growth of state taxes or spending. There is considerable interest in some states, such as Connecticut, in adopting such restrictions. Some of them, such as the Gann Amendment in California and the Hancock Amendment in Missouri, have had major impacts on state fiscal decisions. Many do not because they are statutes that can be superseded by other statutes or constitutional provisions with opportunities for the legislature to exceed the limit by declaring an emergency.

The Texas constitutional limit passed by voters in 1978 limits budget growth to the growth in the state's economy as determined by the budget board of the legislature. The legislature can avoid the restriction by a resolution finding that an emergency exists. The new Texas biennial budget calls for growth of about 17%. The economic growth rate underlying the revenue estimates is 12-14% depending on who is talking. The legislature didn't declare an emergency to comply with the exemption. Therefore, the budget is illegal according to a group called Taxpayers Against A State Income Tax, which expects to start litigation to invalidate the budget. Legislative leaders don't see a problem because the budget board never formally adopted a growth assumption in the last legislative session. So, the new legislature didn't have to follow one because it couldn't do the work a prior legislature failed to do.

Tax Litigation: The U. S. Supreme Court has agreed to decide several cases of considerable importance to state finances. The cases are likely to be decided before the completion of the court's term that ends next summer.

One case concerns mail order sales. Under a 1967 Supreme Court decision, states cannot require mail order sellers in other states to collect their sales/use taxes. As a practical matter, the states can't collect directly from the buyers either, though they are legally liable for a use tax. The revenue loss is $2-3 billion nationally. Many states -- the National Governors' Association counts 34 -- have enacted legislation designed to push the limits of the old decision as far as possible. The result has been considerable litigation. In one of the cases, the North Dakota Supreme Court upheld a state law by concluding that the 1967 Bellas Hess case was no longer operative. The U.S. Supreme Court's decision to take that case is a decision to review the 1967 holding.

A decision favorable to state taxing power would result in an immediate infusion of revenues for states. It would also create a need to decide how to handle the many different local sales taxes that exist in some states. Mail order houses claim that it is difficult for them to collect these taxes. One alternative is for states to establish a blended rate for local taxes, as Missouri has done. The blended rate is a feature of legislation pending in

Congress that is designed to do about the same thing as the North Dakota decision. That legislation appears to be on hold because representatives of states and local government haven't been able to agree on the handling of local taxes.

The second case concerns situations in which comparable properties are assessed (and thus taxed) at sharply differing levels. Under the laws of practically all states, the assessments are supposed to be comparable. Often they are not for administrative reasons, such as a tendency of assessors to update assessments when property is sold without updating assessments of similar property that doesn't change hands. In a landmark case several years ago, the U.S. Supreme Court decided that such practices can violate the U.S. Constitution. In California, the discrimination is an intended consequence of Proposition 13's tax limiting provisions. When property is sold, assessed values are changed to reflect market values. But before property changes hands, the property tax increases are limited. As a result, comparable business and residential property can have sharply differing taxes. Under pressure of a possible boycott, Macy's pulled out of its California case, but a homeowner continued to push the issue, resulting in the U.S. Court's decision to hear arguments and decide the case.

Workers' Compensation: Concerns over the rising costs of Workers' Compensation (WC) are increasing as WC payroll taxes increase. Attempts to limit costs helped delay budget deliberations in California and Maine. Even though WC issues aren't usually in budget bills, Governors McKernan and Wilson sought to tie cost-cutting in WC to cost-increasing tax measures. Little change was made in either state. In Maine, Governor McKernan (R) called off a planned fall special session on the topic after meeting with legislative leaders (D) in what he called "a very unpleasant and short conversation." He concluded the session would be a waste of taxpayers' money.

The subject won't die in these and other states. Benefit increases often lag inflation, making the topic an urgent one for organized labor and creating sympathy among lawyer-legislators who realize that benefits to injured workers in the no-fault WC system are much less than those paid ordinary citizens in tort claims for the same injuries. While labor is dissatisfied with benefits, management is dismayed by growing costs. With corporate profits down and WC costs up, WC taxes often exceed corporate income taxes for manufacturing companies. A steep premium increase gets attention fast, as recently happened in Pennsylvania.

Workers Compensation coverage is mandatory in most situations, though Texas has some glaring examples of exceptions. In some states, the coverage is only "sold" by the state, so the WC payment is a tax. In some states, the coverage is from a private insurance carrier with state-regulated rates and benefit schedules, so the WC payment is a "premium." In both cases, it is a state-mandated payment with the effects of a tax from the employer's perspective. Premiums paid to private companies and the benefits paid by them aren't state funds. WC taxes and benefit payments are state funds, but aren't general funds subject to appropriation. As a result, WC issues aren't a part of the normal budget deliberations. But WC, unemployment compensation taxes, local property and other taxes, and state taxes are all a part of the package of state and local costs as an employer sees them.

TECHNICAL NOTES

Property Taxes: The paper used for Table 3, "The Incidence of Maryland Taxes," was published in Maryland Tax Policy, Volume 4 of Maryland Policy Studies published by the Bureau of Governmental Research, University of Maryland (College Park, MD 20742). The author is Robert Schwab (U. of Maryland). The study methodology, which is the standard one, can provide misleading impressions in some situations. For example, over a lifetime the property tax may seem more burdensome to someone in their 30s with children and a large mortgage than someone retired with neither children nor mortgage. A special problem arises, particularly in central cities, through a combination of inflation and assessment practices. New and/or higher priced housing assessed values tend to lag price changes while inner city assessments reflect full market value of some properties and fail to reflect declining values of others. For example, in Philadelphia, one study (Philadelphia Inquirer, 2/18) found that assessed values were 39% of home values for houses with market value under $25,000, 21.3% for houses worth $75,000-100,000, and 20.8% for houses worth more than $200,000.

Certain forms of state tax relief, particularly circuit breakers and credits or deductions for property taxes paid, make local taxes seem cheaper to local officials because the state pays part of any increase. [They don't make property taxes look cheaper to the Census Bureau, so its statistics overstate property tax burdens where these relief programs are used.] The effect in encouraging higher taxes has been of concern to some state officials, particularly in Wisconsin where there is a widely accepted objective of holding down state and local taxes in relation to personal income. These forms of tax relief may also conflict with school equalization objectives by encouraging more affluent districts to increase spending. See Michael Addonizio (Indiana U.), "School Aid And Property Tax Relief: Some Evidence Of Conflicting Incentives," Journal of Education Finance (Summer 1990). The state relief programs are detailed in the Advisory Commission on Intergovernmental Relations (Washington, DC 20575) study Significant Features Of Fiscal Federalism, Volume 1.

The study on property tax limits appears in the National Tax Journal (June, 1991). The authors, Anne Preston and Casey Ichniowski, are on the faculty of the State University of New York at Stony Brook. The data on property tax assessments come from the Massachusetts Taxpayers Foundation, Public Sector Consultants (Lansing, MI), and the Wisconsin Taxpayers Alliance. The comparisons of property tax burden change were made by the Tax Foundation (Tax Features, May/June) 470 L'Enfant Plaza, SW, Washington, DC 20024. The study of assessments is Property Tax Assessment In Indiana, Indiana Fiscal Policy Institute (251 N. Illinois St., Indianapolis, IN 46204).

State And Local Fiscal Relations: The ACIR study is summarized by Robert Rafuse (ACIR) in Maryland Tax Policy cited above. The counties used in the article are the mountain county of Allegany (poor rural), Baltimore (central city), Calvert County (industrial enclave), and the Washington, DC suburb of Montgomery County (affluent suburb).

Miscellany: The electronic fund transfer survey appears in the Federation of Tax Administrators' Tax Administrators News (July). The exports study by Cletus Coughlin and Thomas Mandelbaum appears in the Federal Reserve Bank of St. Louis Review (July/August). ACIR's study is Changing Attitudes On Government And Taxes.

Most of the items in the discussion of federal grants come from Federal Funds Information For States (400 North Capitol St., NW, Washington, DC 20001). FFIS was established by the National Conference of State Legislatures and the National Governors' Association to improve state sophistication in dealing with federal grant issues, particularly complex grant formulas. It has had something to do with gradual changes since the early 1980s that have reduced the last minute surprises associated with grant allocations and other federal decisions.

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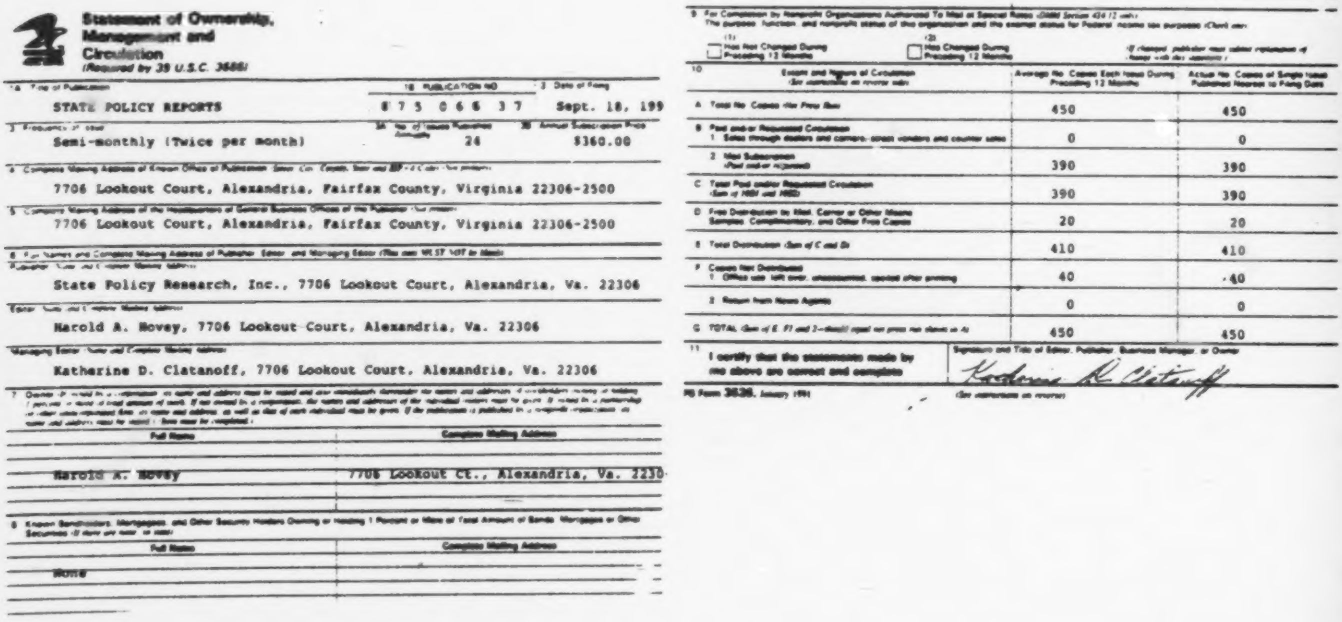

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STATE POLICY REPORTS

VOLUME 9 ISSUE 20

State budgets are based on the assumption that the nation's economic recovery started this summer. No one told consumers and other economic decisionmakers. Unless a turnaround appears soon, the next 12 months in state finances will resemble the last 12.

o Deteriorating State Fiscal Conditions p. 2

This year (FY 1992) only a third of the state budgets contemplate more revenue than spending. Only a third of the states expect to end the year with balances of 2.5% or more of revenues. So if all plans are realized, most states will be in bad shape. Otherwise, they'll be in worst shape.

o This Year's Financial Outlook p. 8

State tax increases will lift state revenues about 5%. About 30 states raised some tax, but the big increases were concentrated in a few states. There was no particular favorite tax to raise.

o Tax Actions And Trends p. 12

State budgets for FY 1992, despite the many tax increases, provide only enough spending growth to match inflation. Medicaid and corrections grew much faster, starving other programs.

o Spending Trends And Outlook p. 15

State employment grew through last October, though the pace has slowed since. There are major differences among states in the number of employees relative to population and in compensation.

o State And Local Employment p. 20

Technical notes provide comments on revenue estimates and amounts reported as tax increases. A summary table shows FY 1991 spending increases for all states for six spending categories.

o Technical Notes p. 23

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DETERIORATING STATE FISCAL CONDITIONS

Introduction: State finances aren't in good shape. Much of this issue is devoted to what state fiscal officials reported to the National Conference of State Legislatures (NCSL) and to the National Association of State Budget Officers (NASBO). That information is valuable in comparing states, examining growth of spending for individual programs, reviewing tax changes, and other purposes. It is less than perfect for predicting exactly what the states will be doing this fiscal year. Sluggish tax collections, the threat of federal disallowance of some Medicaid matching funds, and escalating costs for social programs all suggest that there will be revisions in the state budgets reported in the two surveys.

There are lots of 50-state tables in this issue to give readers a feel for the fiscal situation of each state. Officials of individual states find this useful in determining where they stand relative to other states. Those readers concerned with tax policy like to speculate on where the chances of tax increases are greatest. Those interested in spending like to know the fiscal environment in which they will be pressing their cases.

Things Are Worse Than They Seem: The NASBO and NCSL surveys are imperfect indicators of state financial condition. The reason is simple. They reflect the premises of the state budgets as they were enacted, generally in June. For most states, they don't reflect the bad news that has occurred since June.

First, revenues in May and June were worse than anticipated in many states. This isn't surprising. Even the after-the-fact record keepers in the U.S. Department of Commerce assessed economic conditions incorrectly. They first issued a report showing there was economic growth in the second quarter. Then they revised the finding to show slower real GNP growth. Then they revised the finding again to show economic decline. These revisions paralleled reassessments of state revenues as estimates were replaced by data on actual collections. Lower-than-expected revenue produced lower-than-expected balances going into FY 1992 which, other things being equal, meant lower-than-expected balances at year end.

Second, revenues in July, August, and September have been lower than estimates in many, though not all states. Following the consensus estimates of economists in the spring, state officials predicted more growth than seems to have occurred.

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Third, many states are counting on federal matching money in Medicaid based on bootstrap financing arrangements that may be disallowed by federal action midway through the fiscal year.

Fourth, spending appears to be outrunning expectations in some social service and health programs. The problem is particularly acute in AFDC and general assistance caseloads and thus in Medicaid caseloads. Officials of some states appear to have underestimated caseloads, underestimated cost-per-case, or overestimated the impact of their cost-reducing strategies -- sometimes all three.

Finally, some state budgets reported in the two surveys weren't realistic when they were enacted. The situation is so serious that NCSL's report warns of it.

Signs Of The Times: Employment changes provide the best single indicator of what is happening in individual state economies. Table 1 reflects the situation in the larger states. It shows job loss in the last year as a percentage as well as the numbers of jobs involved and, in the final column, provides the unemployment rate this September.

Table 1: Change In Employment In Major States
September 1990 To September 1991

State	Percent Change	Job Change	Unemp. Rate
Michigan	-4.0%	-172,000	9.2%
Massachusetts	-3.6	-107,000	8.9
New York	-2.7	-223,000	6.8
New Jersey	-1.6	-61,000	6.0
Florida	-1.2	-70,000	8.0
Ohio	-1.0	-51,000	5.7
United States	**-0.5**	**-626,000**	**6.4**
Illinois	-0.4	-24,000	6.6
Pennsylvania	-0.3	-19,000	6.3
Texas	0.2	13,000	6.4
California	0.6	85,000	7.5
North Carolina	1.7	56,000	5.3

These numbers have dramatic impacts on state finances even by back-of-the-envelope calculations. If average pay of job losers was $15,000, Michigan's job loss in one year translates into lost income of about $2.58 billion. With state and local taxes taking about 11% of personal income, that means lost revenues of nearly $300 million.

Table 1 also shows major differences among the states. Reasonably current data for 50 states appear in the Index of State Economic Momentum (Issue 18). The Index shows that states in the West are doing somewhat better than the national average while East Coast states are doing worse. That geographic pattern is reflected in state finances.

How The Bottom Fell Out: The unanticipated recession was, far and away, the largest single contributing factor to state fiscal problems this year.

The conclusion is significant because to the extent recession is the problem, recovery is the solution, not necessarily permanent tax increases or spending cuts. If structural defects in state budgets are the problem, then recession merely worsens an already difficult fiscal situation. The worst case is to have both a recognizable structural deficit and problems clearly associated with recession. This was the California case, with a portion of the tax increase designed to be a temporary response to the economic downturn.

The recession's impact fell primarily on revenues, though there was some effect on general fund spending for welfare and Medicaid. The NASBO report provides data on original and current estimates for three major taxes in FY 1991: sales, personal income, and corporate income. Corporate receipts, which are about a fourth of each of the other two taxes, were 13% below estimates. Sales tax revenue shortfalls in relation to original estimates are shown on Table 2. States listed without values don't have sales taxes.

Table 2: Shortfalls in FY 1991 State Sales Tax Revenues
As Percentage of Original Estimate

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New York	-17.1%	17	South Carolina	-4.2%	34	Hawaii	1.3%
2	New Jersey	-13.0	18	Massachusetts	-3.7	35	Arkansas	1.5
3	Maryland	-9.4	19	Mississippi	-3.27	36	Utah	2.0
4	Rhode Island	-9.4	20	Arizona	-3.17	37	Colorado	2.1
5	Virginia	-8.4	21	Nebraska	-2.7	38	Nevada	2.5
6	Connecticut	-7.8	22	Georgia	-2.5	39	Wyoming	2.7
7	Michigan	-7.8	23	Vermont	-2.3	40	Louisiana	2.8
8	California	-7.4	24	Oklahoma	-1.6	41	South Dakota	2.9
9	Florida	-7.3	25	Minnesota	-1.0	42	North Dakota	3.1
10	North Carolina	-6.5	26	Alabama	-1.0	43	West Virginia	7.0
11	Indiana	-6.1	27	Idaho	-0.9	44	Washington	10.9
12	Pennsylvania	-5.8	28	Kentucky	-0.6	45	New Mexico	11.8
13	Ohio	-4.8	29	Wisconsin	0.0		Alaska	
	United States	-4.6	30	Texas	0.00		Delaware	
14	Illinois	-4.4	31	Kansas	0.1		Montana	
15	Missouri	-4.3	32	Maine	0.4		New Hampshire	
16	Tennessee	-4.2	33	Iowa	1.1		Oregon	

The national average is a shortfall of 4.6% -- a devastating impact in the context of already enacted state budgets.

Deviations among the states are significant. Differences between individual states and the national average come from such factors as the differing times when original estimates were made, differing conservatism in revenue estimating, and unpredicted deviations between state and national economic performance. Apparently there was a tendency for revenue estimators to assume that their states' economies would perform like the national average. As a result, the top listed states in Table 2 are East Coast states that felt recession most severely. States in the right hand column have been outperforming the national economy.

Table 3 provides the same information for personal income taxes as Table 2 provides for sales taxes.

Table 3: Shortfalls in FY 1991 State Personal Income Tax Revenues
As a Percentage of Original Estimate

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	-21.9%	17	Kentucky	-3.6%	34	Arkansas	2.3%
2	Virginia	-12.6	18	Massachusetts	-3.6	35	Oklahoma	2.4
3	California	-9.9	19	Ohio	-3.5	36	Montana	2.7
4	North Carolina	-8.8	20	Colorado	-2.5	37	Wisconsin	4.4
5	New Mexico	-8.8	21	Mississippi	-2.5	38	Hawaii	7.3
6	South Carolina	-8.3	22	Minnesota	-2.3	39	Idaho	8.0
7	North Dakota	-8.1	23	Vermont	-2.3	40	New Jersey	8.4
8	Delaware	-7.6	24	Maine	-1.6	41	West Virginia	9.3
9	Rhode Island	-6.8	25	Kansas	-1.5	42	Utah	11.3
10	New York	-6.7	26	Alabama	-1.2		Alaska	
11	Maryland	-6.6	27	Indiana	-0.9		Florida	
12	Michigan	-5.6	28	Iowa	-0.5		Nevada	
13	Georgia	-5.2	29	Arizona	-0.1		New Hampshire	
14	Tennessee	-4.9	30	Illinois	0.1		South Dakota	
	United States	-4.6	31	Oregon	0.6		Texas	
15	Missouri	-4.4	32	Nebraska	1.0		Washington	
16	Pennsylvania	-4.0	33	Louisiana	1.5		Wyoming	

Revenue Estimating Accuracy: These tables suggest state revenue estimators predicted revenue badly, with an average error of 4.6% nationally for both taxes. Basing a budget on the original estimates and then undertaking a mid-course correction to maintain balance would have required across-the-board spending cuts of 4.6%. That is about what happened in a few states.

In most states, the impact on spending was less severe. Some of the original estimates were revised downward before the FY 1991 budgets were enacted. Also some of the estimates of final outcome were not made until too late to adjust spending, so part of the shortfalls cut into balances rather than resulting in lower spending.

Nonetheless, the large errors documented in Tables 2 and 3 have caused great consternation among some state elected officials. As a result, some states are reassessing their revenue estimating procedures to determine what went wrong and what can be done better in the future. More such assessment may occur as these two tables circulate in the states. The underlying NASBO numbers, as presented in its report, don't leap out at the reader with particular conclusions. Calculating percentages and ranking states, as **Reports** has done, leads to some obvious questions such as why the estimating errors were so large and, particularly, why they differed so much among states in comparable circumstances.

It is plausible that state officials could make errors of this magnitude by using revenue estimating techniques that will, on reexamination, be continued with little change because they are the best available. The gross underlying error was assuming that national economic growth would continue at a 2-4% clip. It didn't. The actual number, when finally decided upon by the keepers of the national income accounts, will be around 0%. The difference accounts, more or less, for a 2-4% error.

In the personal income tax, the error is magnified by refunds of money already counted. For example, someone who lost a job in the fall of 1990 would have paid full withholding during all of a state's FY 1990 but FY 1991 revenue would suffer both: (1) from the loss of withholding from the job loss and (2) from refunds claimed in early 1991 based on overwithholding in 1990. Sales tax losses would also be more than the decline in economic activity because the decline disproportionately affected sales of big ticket items like furniture and cars. So the results shown for most states on Tables 3 and 4 aren't totally out of line. A discussion of states deviating grossly from the national average appears in the Technical Appendix.

Planning For Recession: It is unlikely that states will avoid the fiscal shocks of recession years like 1991 by improving revenue estimating procedures. The big mistake of state estimators was following what was then the consensus of national economic forecasters (or their own econometric consulting service which itself mirrored the consensus). The error could have been avoided if state estimators had independently forecast recession. But such totally independent forecasts aren't likely to develop. First, state revenue estimators are not, and are not believed to be, better national forecasters than the national forecasters and therefore would have a credibility problem. Second, state estimators aren't likely to stray far from the national consensus for the same reasons corporate economists don't. Third, and perhaps most important, elected officials aren't going to find it easy to deny pay raises and school aid increases based on economic assumptions sharply different from those prevailing at the time. When a state estimator forecasts recession when others making forecasts don't, this is exactly what state officials are asked to do.

This means the cure for the budget revisions of 1991 lies elsewhere. There are several successful strategies. The first is conservatism in the estimates. This is difficult to measure, but is particularly found in states with volatile commodities prices affecting their income or a spurt of income growth that might not continue. Examples where revenues were above estimates in FY 1991 are Alaska, the Dakotas, Utah, and West Virginia. A second approach is to appropriate less than a full revenue estimate indicates, which is done by automatic procedures in Oklahoma and South Carolina.

A third approach is to have a substantial portion of the budget in items that can be deferred if revenue estimates are wrong. Examples are capital outlays to be paid out of general revenue, salary increases contingent on resources being available, and the like. This is how Virginia adjusted without tax increases. Arkansas makes the whole budget dependent on revenues available by appropriating in priority classes (tiers). Alabama's practice is to prorate education appropriations depending on fund availability. The fourth approach is to have money in the bank in the form of balances and rainy day funds. This is how Indiana avoided excruciating budget cuts or major tax increases.

Developments This Fall: The developments in many states in the first three months of the fiscal year suggest serious difficulties if there is no national economic turnaround soon. California's problems are the most striking. In late October, the governor began talking of a shortfall of $2 billion or so. The Commission on State Finance revised its estimates of spending and revenues to indicate a projected FY 1992 shortfall of about that amount. New York's mid-year budget review also indicated a shortfall. In both cases, the cause is a combination of revenues dropping below estimates and spending, particularly for Medicaid and social services, running above estimates.

Problems in the Southeast produced such large shortfalls that most affected states have already taken major action to reduce spending. Georgia and Maryland held special legislative sessions for the purpose. Florida's governor decided he could take about the same action without legislative approval. The state supreme court has held otherwise, making a session necessary. Alabama and Mississippi budgets are in proration, a proportionate reduction of expenditures to match the reduction in revenue estimates.

Judging what administrative cutbacks to make in state budgets is difficult. Recent economic statistics have been ambiguous about whether recovery is on the way. By failing to act quickly, state officials risk finding their budgets widely out of balance if national economic recovery doesn't occur. But when recovery comes, it might well be quite rapid, such as GNP growth at a 6% annual rate rather than the 3% of the late 1980s. So acting quickly could leave state officials administering major cuts in already austere budgets at the same time that revenues are rolling in above expected levels.

THIS YEAR'S FINANCIAL OUTLOOK

Introduction: The FY 1992 budgets indicate problems in three important dimensions of financial health. Balances going into the year are low. Spending during the year will exceed revenue during the year in nearly half the states. Planned balances at the end of FY 1992 are low by historical standards and by most standards of prudent reserves.

Operating Surplus Or Deficit: A simple, but relevant, way of looking at state finances is whether money taken in during the year is expected to be enough to pay that year's bills.

State definitions of deficit and surplus are comparable to those individuals use in keeping checkbooks. If there is a positive balance at the end of the year, the budget is considered balanced whether there was a penny in the bank at the beginning of the year and at the end or there was a massive balance at the beginning that shrank to nothing at the end. In corporate and federal accounting, spending more than revenues would show a deficit.

Putting state budgets on a private sector basis provides some revealing statistics. Table 4 was developed from statistics in the NASBO report. The numbers shown reflect the excess (deficit) of revenues in FY 1992, the new budget year, as a percentage of spending.

Table 4: FY 1992 State Operating Surplus/Deficit
As a Percentage of Expenditures

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	California	6.7%	17	New York	0.1%	34	South Dakota	-0.9%
2	Hawaii	4.4	18	Maryland	0.0	35	Indiana	-1.1
3	Pennsylvania	3.3	19	Alabama	0.0	36	Ohio	-1.1
4	Alaska	2.1	20	Arkansas	0.0	37	Nevada	-1.4
5	New Jersey	1.6	21	Colorado	0.0	38	Utah	-1.6
6	Maine	1.5	22	Connecticut	0.0	39	Oregon	-2.2
7	Vermont	1.4	23	Michigan	0.0	40	Kentucky	-2.9
8	Oklahoma	1.1	24	North Carolina	0.0	41	Washington	-3.1
9	New Mexico	1.0	25	Rhode Island	0.0	42	West Virginia	-3.3
10	New Hampshire	0.9	26	Tennessee	0.0	43	Kansas	-3.5
11	Illinois	0.8	27	Iowa	-0.0	44	Idaho	-4.5
12	Florida	0.8	28	Mississippi	-0.0	45	North Dakota	-6.5
13	South Carolina	0.6	29	Delaware	-0.2	46	Texas	-7.1
	United States	**0.4**	30	Georgia	-0.3	47	Nebraska	-7.3
14	Arizona	0.4	31	Massachusetts	-0.5	48	Montana	-8.7
15	Virginia	0.4	32	Wisconsin	-0.6	49	Louisiana	-8.8
16	Missouri	0.2	33	Minnesota	-0.8	50	Wyoming	-9.8

Just over a third of the states are operating in the black by covering current spending with current revenues, using any money left over to rebuild reserves. Another third are spending at least 1% more than their revenues. How safe this is depends on how large reserves are.

Assessing Projected Operating Results: The situations of the states shown on Table 4 fall into several distinct categories as shown in Table 5.

Table 5: FY 1992 State Fiscal Strategies

Fiscal Situation/Strategy	Operating Surplus	Ending Balance	Number of States
Rebuilding Balances	Over 1%	Over 1%	8
Normal Operation	0-1%	State's Own Target (0-7%)	18
Using Large Balances	Negative, In Deficit	Over 5%	8
Deficit Operation/ Low Balances	Negative, In Deficit	Under 5%	16

Eight states, the top-ranked states on Table 5, are planning to rebuild their reserves with their FY 1992 budgets. Mostly they are states that enacted large tax increases and are using the money to pay expenses in FY 1992 and recoup losses in their financial position from prior years. California, Pennsylvania, Maine, and Vermont are the examples. The others are special cases of reasonable prosperity (Alaska and Hawaii) or tax increases last year (Oklahoma and New Jersey).

If all were going smoothly in a state's finances, the number shown on Table 4 would be slightly above zero. Revenues would cover spending and, to keep balances at a steady 3-5% of expenditures, states would add about 0.2-0.4% to balances. This addition to balances would keep them a constant percentage of growing spending. Eighteen states more or less fit this pattern with operating surpluses ranging between zero and 1%.

Another pattern consistent with strong state financial management is to spend more than current revenues because balances at the beginning of the year were above the state's targets. Spending part of that money will produce a negative number on Table 4, but still leave the state in a strong position. Eight states show negative numbers on Table 4 but project ending balances at 5% of spending or more. They (and their ending balances) are Delaware (9%), Indiana (6%), Minnesota (7%), Nebraska (11%), Nevada (5%), North Dakota (15%), Oregon (12%), and Washington (7%).

The hazard is that the resulting spending pattern will be greater than revenues in FY 1993 can sustain. The hedge against that hazard is using some of the spending for one-time items such as capital outlays, one-time extra contributions to pension systems, and accelerating payments of employees, vendors, and local governments.

States With Apparent Fiscal Problems: The categories above leave a whopping 16 states, a third of the nation, with fiscal problems in their enacted budgets shown by the numbers used when they were enacted. For the reasons stated at the beginning of this article, their problems now seem worse than when they enacted the budgets summarized by the tables in this issue.

Out of this group there are some special cases such as Wyoming's ample resources in special funds and Idaho's and Utah's prosperous economies. The others are indicative of built-in fiscal problems for states in FY 1993 even if the economy recovers somewhat, as is assumed in most state budgets.

Louisiana and Mississippi avoided tax increases in their election year. In Mississippi, the post-election period will see a resumption of education finance discussions. Both a sales and an income tax increase have passed one House or the other, but the governor has held out for a lottery and fee increases. The state's aspirations for education, many enacted into law, would require substantial new revenue. Louisiana has a tradition of running down reserves in an election year, followed by a post-election tax increase. Finances were not much discussed in the campaign but will soon become a major issue.

There is considerable sentiment for tax increases in Montana and Wisconsin. Legislatures in these states (and also Minnesota) passed tax increases that were vetoed by governors. In Kansas, a majority of legislators wanted one tax increase and the governor wanted a different and larger one. In these states, and more, tax increases are likely to be on the agenda next year.

This leaves other states, each with relatively unique problems and circumstances. In Texas, the major risk is a reopening of the school finance cases plus cost overruns in Medicaid and social services. In Oregon, the problem is adjusting to a limit on local property taxes that, sooner or later, will require a large infusion of state resources. In Georgia, the question is whether the spending cuts already made after FY 1992 began will be enough. In Delaware, Indiana, Iowa, Kentucky, Ohio, South Dakota, and West Virginia, the question is how well the revenue and spending estimates will hold and whether decisionmakers will accept relatively austere spending levels in FY 1993.

Projected State Balances: One common indicator of state fiscal condition is the balances held as surpluses and rainy day funds.

From time to time, a figure of 5% of a year's spending is discussed as a target for each state, a prudent level of reserves. There is no empirical base for such a nationwide target. Logically balances for states, like cash reserves for households, should differ depending upon the risks to which each is subject and the other hedges against uncertainty present in individual financial practices.

For example, states like Arkansas and Alabama with strong traditions and laws for adjusting spending downward to cover revenue surprises shouldn't need the same balances as states where such traditions and laws are weaker. States with diversified economies, like Illinois and California, shouldn't need balances as large as those dependent on a few industries or firms like Oklahoma, the Dakotas, and Washington. Those dependent on volatile graduated personal income taxes and corporate income taxes, like Minnesota and Wisconsin, should have larger balances than those dependent on sales taxes and corporate franchise taxes like Texas and Washington. States with reserves tucked away in various special funds, like Alaska and Wyoming, need less cushion than those with accounts payable lurking in various accounts, like New York.

Some states have their own balance targets established by law or practice. For example, the target in Arkansas is 0% while the California target is 3%.

Despite these differences, the comparison of balances shown in Table 6 can be useful in considering how states relate to each other.

Table 6: Projected Total Balances as a Percentage of Expenditures, FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Vermont	-7.3%	18	Tennessee	0.5%	34	Michigan	2.8%
2	New Hampshire	-3.9	19	Louisiana	0.7	35	Kansas	2.9
3	Texas	-3.7	20	Missouri	0.9	36	Colorado	3.3
4	Alabama	0.0	21	West Virginia	1.1	37	California	3.6
5	Arkansas	0.0	22	Wisconsin	1.1	38	Wyoming	4.1
6	Connecticut	0.0	23	Florida	1.2	39	New Mexico	4.6
7	Georgia	0.0	24	Ohio	1.2	40	South Dakota	4.8
8	Iowa	0.0	25	Arizona	1.5	41	Nevada	5.1
9	Massachusetts	0.0	26	Illinois	1.6	42	Indiana	6.4
10	North Carolina	0.0	27	New Jersey	1.6	43	Minnesota	6.9
11	Pennsylvania	0.0	28	Kentucky	1.7	44	Washington	6.9
12	Utah	0.0	29	Maine	1.8	45	Delaware	8.8
13	New York	0.1		**United States**	1.9	46	Nebraska	10.8
14	Rhode Island	0.1	30	Alaska	2.1	47	Oregon	11.6
15	Mississippi	0.2	31	Montana	2.1	48	Oklahoma	13.1
16	Maryland	0.3	32	Idaho	2.4	49	North Dakota	15.3
17	Virginia	0.4	33	South Carolina	2.4	50	Hawaii	17.1

Negative numbers, as shown for three states, are bad news. The Texas number reflects a single year of a biennium, with the state's balanced budget requirement applicable to the biennium. Only ten states meet a 5% target. The balances are dramatically lower than in the late 1980s. From the end of FY 1984 through the end of FY 1990, balances were in a range from 3.1% to 5.2% of spending. They dropped to an estimated 1.5% at the end of FY 1991 and are predicted to rise to only 1.9% as result of the new budgets.

The balances are truly slim. For example, if economic growth in FY 1992 turns out to be at a 1.5% annual rate rather than 3% assumed in many budgets, the balances would (without tax increases or spending cuts) drop to about zero. If Medicaid and corrections spending overruns follow past patterns, supplemental spending bills could chop about 1% out of the planned 1.9% balances.

TAX ACTIONS AND TRENDS

Large Tax Increases In 1991: The tax increases in 1991 were massive by the standards of the recent past. Total increases reported in the surveys were about 5-6% of revenue, depending on who is doing the counting. This is the largest percentage increase since 1971. The amount of the increase is the greatest in history. Table 7 shows the increases in recent years as shown by the two surveys and the percentage shown by the NCSL survey. The reasons for the discrepancies between the NCSL and NASBO reports are discussed in the Technical Appendix.

Table 7: Tax Increases Enacted In 1991 for FY 1992 ($ billion)

Fiscal Year Affected	Percent Of Revenue	Amount NCSL	Amount NASBO
1992	5.4%	$16.2	$15.0
1991	3.4	9.5	10.3
1990	1.3	3.5	4.9
1989	0.2	0.6	0.8
1988	1.9	4.5	6.0
1987	0.5	1.1	0.6
1986	-0.6	-1.3	-1.1

The returns may not all be in. In the last major recession, some states adopted major tax increases in special sessions after the November elections. Colorado recently held a special session on funding the school aid formula, but didn't reach agreement on any tax measures. There are discussion of special sessions in Maryland and Tennessee and probably other states.

Tax Increases By State: There were tax increases in about 30 states. Table 8 shows the percentage increases in taxes as reported by NASBO, expressed by **Reports** calculation as a percentage of FY 1991 revenue. The table is designed to answer the question of which states raised taxes how much and, thus, which tax increases were the largest relative to other states. The table includes only those states where some change in tax levels occurred.

Table 8: Tax Increases As a Percent of Revenue, FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Pennsylvania	21.5%	13	Montana	5.4%	24	New Mexico	1.0%
2	Nevada	18.0	14	Tennessee	5.2	25	South Carolina	0.8
3	Connecticut	15.9		**United States**	**5.0**	26	Washington	0.8
4	Arkansas	14.4	15	Minnesota	5.0	27	Alabama	0.6
5	Vermont	13.0	16	Nebraska	3.8	28	Hawaii	0.6
6	California	12.3	17	Oregon	3.5	29	Wisconsin	0.6
7	Maine	11.9	18	New York	2.7	30	Iowa	0.6
8	Missouri	8.1	19	Florida	2.4	31	Arizona	0.2
9	North Carolina	7.9	20	Maryland	2.3	32	Michigan	-0.1
10	Delaware	7.7	21	Idaho	1.6	33	New Jersey	-0.2
11	Texas	6.7	22	Ohio	1.3	34	Louisiana	-0.3
12	Rhode Island	5.6	23	Illinois	1.2	35	Massachusetts	-1.5

These tax increases differ from many of those in the late 1980s in one respect: Most didn't buy anything of direct interest to voters. The typical tax increases were primarily oriented to purposes called "balancing the budget," "avoiding spending cuts," and "keeping the doors of state government open." There were some exceptions. The Arkansas and Missouri increases, for example, were associated with increased education spending.

Local Taxes: Neither of the surveys attempts to assess the impact of state decisions on local tax rates. Some of the impacts were substantial. In some cases, state legislatures approved new taxing authority for local government. The approval of a local option sales tax for Philadelphia and a package of local taxes for New York City are examples. In other cases, state decisions to cut local aid forced local decisions on cutting spending or raising taxes. Some of these decisions were, no doubt, made in favor of increasing taxes. Examples are Massachusetts, New York, and Rhode Island. In other cases, the state action in rewriting the school aid formula forced local property tax increases. Examples are Kansas and Texas.

Which Taxes Were Increased? There was no particular favorite among taxes to increase. Table 9 shows the increases reported in the two surveys. For lack of any compelling reason to use one survey or the other, Table 9 includes both. Unintentionally, this has the effect of highlighting large differences among the two organizations in reporting (1) how much taxes were raised and (2) what taxes were raised. These differences are locally significant in some states, but don't affect the major conclusions about tax policy nationwide.

Table 9: State Taxes Increased In 1991 ($ million)

	Amount		Percent Of Total	
	NCSL	NASBO	NCSL	NASBO
Personal Income	$6,495	$5,430	39.9%	36.1%
Sales	5,062	3,850	31.2	26.5
Corporate Income	1,690	1,439	10.4	9.6
Tobacco	217	246	1.3	1.6
Alcoholic Beverage	220	204	1.4	1.4
Motor Fuels	716	629	4.4	4.2
All Other	1,817	3,232	11.2	21.5
TOTAL	$16,217	$15,029	100.0%	100.0%

Personal income taxes were relied upon more than others nationwide, but nearly all of the increase reflects the large increases in California, Connecticut, and Pennsylvania. The other significant developments were increases in a few states that were part of a package also involving sales (e.g., Maine, Missouri, and Vermont) or relatively minor adjustments involving special groups such as retirees, higher income taxpayers (New York), and real property tax deductions (Illinois).

California's $2.5 billion increase dominated the sales tax category. The other large increases were in Arkansas, Maine, Minnesota (a mandatory local option oxymoron), Missouri, Nevada, North Carolina, Pennsylvania, and Texas. Connecticut used some of its revenue from the new income tax to lower sales taxes.

Major corporate income changes were confined to a few states. The total of $1.4 billion of increases consists primarily of $552 million in California and $601 million in Pennsylvania. Smaller increases in Arkansas, Maine, Missouri and North Carolina reflect a corporate share of a total tax increase that primarily consisted of taxes on individuals.

Excise taxes didn't gain much attention. NASBO counts nine states that raised gasoline taxes. These per-gallon taxes tend to be increased over time as the purchasing power of their revenue declines with inflation and greater gas mileage of newer vehicles. Some states make this adjustment administratively. Others act in relatively large increments every three to five years. Uncertainty about the still-pending federal highway legislation renewal may have held down the number of gas tax increases.

Excises on tobacco products and alcoholic beverages weren't popular. This is consistent with the role they appear to have assumed in state revenue raising. They are often used to raise relatively small amounts of money in situations where elected officials want to be able to assure the electorate that they haven't raised general taxes or, as some put it, broad-based taxes. But when heavy lifting is required as was the case this year, they are less often tapped. Their revenue contribution is limited, their likely yield growth is negative, and politically they carry with them possible opposition to be piled on top of whatever opposition already exists to raising taxes.

There were only two increases of alcoholic beverage taxes. The North Carolina increase was part of a package that deliberately raised every tax. The California increase was supported by alcoholic beverage interests, who fear even larger increases by voter initiative. There were 13 states with some form of tobacco tax increase, with Pennsylvania's accounting for about half the revenue raised.

SPENDING TRENDS AND OUTLOOK

Introduction: State spending trends are simultaneously showing two developments that contrast with the pattern of much of the 1980s. One is slower overall growth in spending. The second is a larger percentage of spending increases being devoted to Medicaid and corrections spending. They are not necessarily growing faster in percentage terms, but past high percentage growth has made them a larger share of the budget. As a result, the continuing large increases take a larger and larger bite out of funds available for other programs.

Total Spending Growth: As estimated by the states responding to the NASBO survey, total state general fund spending will increase by 5% to a total of $302 billion. Constrained by mid-year cutbacks, the reported increase for FY 1991 is 4.5%. The comparable figures from the NCSL survey are 5.4% and 4.9%. These numbers are all close to the inflation rate that has prevailed for the last several years.

The growth rate is considerably below the late 1980s. In the five years of FY 1986 through FY 1990 state general fund spending grew by about 7.5%, which was nearly 3% above the inflation rate. With such a change in the fiscal environment, some beneficiaries of state spending had to lose increases they were accustomed to receiving. In the new fiscal environment, some trends of the 1980s were under substantial pressure. They include: (1) state employee and teacher wage increases exceeding inflation by a substantial margin, (2) growing percentages of school costs paid by state aid rather than property taxes or the federal government, and (3) large increases in Medicaid and corrections, often funded without tax increases.

Planned Spending Increases By State: Table 10 ranks the states based on the spending increases they reported in the NASBO survey.

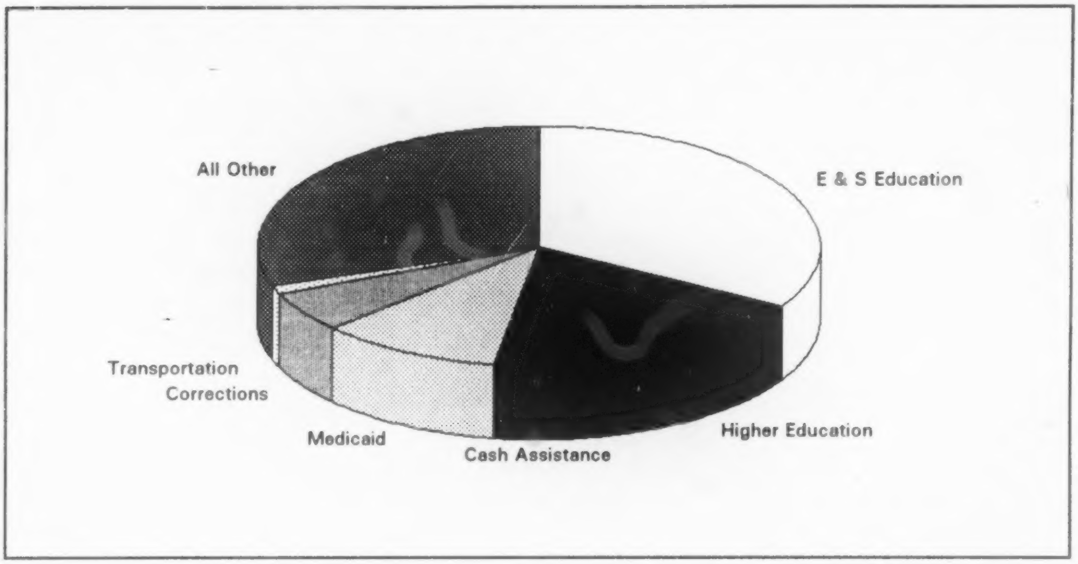
Table 10: Projected FY 1992 Spending Increases

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New Jersey	16.4%	17	Arkansas	4.9%	34	New Hampshire	2.3%
2	Montana	14.6	18	Ohio	4.9	35	Colorado	2.0
3	Oregon	13.8	19	Arizona	4.4	36	Maine	1.8
4	Pennsylvania	12.3	20	Maryland	4.2	37	Missouri	1.5
5	North Dakota	12.2	21	South Dakota	4.2	38	Kansas	1.5
6	Texas	12.1	22	Alaska	4.1	39	Georgia	1.3
7	Florida	11.1	23	Utah	4.0	40	Wyoming	1.0
8	Nebraska	10.9	24	Washington	3.8	41	Indiana	0.3
9	Kentucky	10.1	25	Vermont	3.6	42	Tennessee	0.2
10	Idaho	8.4	26	Delaware	3.3	43	Louisiana	0.1
11	West Virginia	7.6	27	New York	3.2	44	Michigan	-0.1
12	Nevada	7.2	28	Wisconsin	3.2	45	Virginia	-0.1
13	California	7.0	29	Oklahoma	3.0	46	South Carolina	-1.2
14	North Carolina	6.4	30	Mississippi	2.9	47	Connecticut	-1.5
15	New Mexico	6.1	31	Rhode Island	2.9	48	Hawaii	-2.1
16	Illinois	5.9	32	Alabama	2.4	49	Massachusetts	-3.0
	United States	5.0	33	Iowa	2.3	50	Minnesota	-6.0

The table suggests that the national average is no where near the typical (median) state, which has budgeted an expenditure increase of about 3.5%. Twenty-four states show increases of at least 1% but less than 5%. Most of the states with double digit increases are those that increased taxes. There are a few special situations (e.g., Montana and Oregon) that reflect misleading year-to-year comparisons because of a state decision to allocate spending to one year rather than another.

Seven states show actual cuts. Adjusting for inflation, these figures mean they are planning a 5% (Michigan and Virginia) to 11% cut in the real level of state activities. Past patterns suggest these forecasts may not be realized, at least not on an apples-to-apples basis. In part they are driven by shifts in financing responsibility by expecting local governments to accept lower state aid. In part, they represent sharp curtailment of capital projects traditionally funded through the general fund. But in part, they also reflect optimism about ability to control costs in programs like Medicaid.

Spending Growth By Program: As shown in the chart, education constitutes about half of state general fund spending.



The relative share of education is significantly threatened by the forces working on state budgets. With total spending growth in the 5-7% range and Medicaid and corrections growth in the 8-20% range, education must be squeezed to increases below 5-7%. This doesn't show in projected spending, for reasons discussed below, but it does appear in the FY 1991 increases reported in NASBO's special expenditure survey. Table 11 contrasts three indicators of program preferences in state budgets; (1) the NCSL fiscal survey's report on FY 1992 percentage increases, (2) the NASBO expenditure report on FY 1991 increases, and (3) the FY 1992 increases for Georgia reported to NCSL. Georgia was selected because it is an austere budget (no major tax increases) and reflects candid assessments of what the state is likely to spend.

Table 11: Three Views of Percentage Increases In State Budgets

Program	NCSL	NASBO	Georgia
Elementary And Secondary Education	8.9%	5.7%	1.2%
Higher Education	2.2	5.6	3.8
Cash Assistance/AFDC	1.2	6.7	10.6
Medicaid	21.8	20.9	20.0
Corrections	8.0	11.4	12.8
TOTAL GENERAL FUND	4.9	7.3	-1.0

Georgia's strategy is clear from the table. Given a tight budget, federal mandates, desires to avoid cutting existing health and cash assistance for the poor (which is not generous by national standards), the state's decisionmakers explicitly squeezed education in the FY 1992 budget. Within a much more generous total increase, this is also what the NASBO report indicates all states did in FY 1991.

The NCSL report reflects this pattern in double digit increases for Medicaid and corrections. However, it reflects a smaller increase in AFDC and a larger increase in elementary and secondary education than the other two. There are two major reasons why. First, the AFDC budgets reflect underestimates, given all anyone now knows about caseload changes. As NCSL's report politely puts it, the state budgeters are optimistic but, "their optimism may by misplaced. "Second, the education spending is an average that is heavily influenced by massive increases in large states that raised taxes such as California and New Jersey which both reported a 22% increase.

Examples Of State Strategies: While the budgeted increases for individual programs for FY 1992 may deviate considerably from what will actually be spent, the same problem shouldn't arise as seriously in the FY 1991 spending estimates. This spending was reported when the books were already being closed on the year, so there will be few changes in most states. Table A-1 in the Technical Notes shows the percentage change in spending for 50 states and five programs plus the total general fund. Table 12 (opposite page) is a selection of states to illustrate the current choices being made in state budgets.

Typical Spending Priorities: The typical state didn't increase taxes in 1990, so its total FY 1991 budget increase was the 5-8% that could be funded with current taxes. Of the states shown, Pennsylvania did more, but only at the expense of needing the large tax increase enacted this year. Education typically received increases that were lower than the overall spending increases and, in states that didn't raise taxes, at or below the inflation rate. Cash assistance increases were well below Medicaid increases, even though there is substantial overlapping of recipients in the two programs. There were two reasons for this. First, federal mandates added Medicaid recipients. Second, health care providers more often got reimbursement increases than welfare recipients got payment increases.

Education Cuts: The six states shown under "education cuts" on Table 12 illustrate the pressure that higher spending for welfare, Medicaid, and corrections put on education when state spending growth is low. Cash assistance grew by an average of over 10% in these states while Medicaid grew at over 20%. Corrections spending growth showed more variation. Total budget increases ranged from 6% in Tennessee to shrinkage in Massachusetts and Rhode Island. Three of the six states cut public school aid and five of the six reduced higher education spending.

Money To Spend: The last group of states shows the path to double digit increases for public schools. Washington did it by extraordinary economic growth while the other four states used tax increases. Their pattern of increases for welfare, Medicaid, and corrections wasn't greatly different from other states.

Table 12: Percentage Change In FY 1991 Spending, Selected States

State	El. & Sec. Education	Higher Education	Cash Assistance	Medicaid	Corrections	Total
National Pattern						
UNITED STATES	**5.7%**	**5.6%**	**6.7**	**20.9**	**11.4**	**7.3**
Arkansas	4.2	1.8	19.7	3.8	9.0	4.7
California	3.6	9.6	6.0	17.1	15.8	6.9
Illinois	2.3	3.7	5.5	13.4	13.3	8.0
Missouri	4.0	3.1	11.0	45.9	8.2	5.3
Ohio	5.7	3.4	10.4	20.3	14.2	8.0
Pennsylvania	5.9	6.3	10.1	48.7	18.9	10.2
Virginia	5.5	3.6	6.8	27.7	14.9	4.8
Education Cuts						
Connecticut	-7.0	7.2	15.4	30.6	30.5	3.9
Georgia	2.3	-0.2	18.1	40.2	-9.2	4.3
Massachusetts	-14.5	-9.6	6.4	12.2	6.4	-0.7
New York	1.0	-0.7	10.5	20.2	3.9	2.6
Rhode Island	-15.3	-9.0	21.9	16.1	13.2	-0.3
Tennessee	3.2	-2.5	19.0	23.3	3.7	6.0
Money To Spend						
Kentucky	18.6	13.4	15.5	27.0	17.8	16.3
Nebraska	79.3	14.5	7.4	12.4	32.7	24.3
Oklahoma	20.1	5.1	7.6	10.1	14.1	10.5
Texas	12.2	5.9	21.1	34.5	21.5	11.1
Washington	12.7	7.0	6.1	17.7	11.1	17.9

Education As The Swing Spending Category: This table is suggestive of the worst fears of those concerned with education. It would appear, at least in the FY 1991 budgets, that education was the swing category. Major increases were accepted by state budgeters in welfare, corrections, and Medicaid. If economic growth was slow and taxes weren't raised, education got what was left over. This often wasn't much by historical standards. If growth was fast or taxes were increased, essentially all the extra growth went for education.

For several years, state officials have been complaining that rapidly escalating Medicaid costs are sharply curtailing their ability to fund other programs, particularly education. Now enough time has passed so that data are available to see whether this is true. It seems to be.

STATE AND LOCAL EMPLOYMENT

Introduction: While the media reports are filled with announcements of layoffs in state and local government and shortages of state and local workers, state and local employment has been steadily growing.

Nationwide Patterns: Comprehensive statistics on public employment are kept by the Census Bureau which provides detail, but only with a lag in reporting. The latest information is from Public Employment: 1990, a report based on October 1990 payrolls that was issued recently. It shows steady increases in state and local employment as shown in Table 13 for total employment, full-time equivalent (FTE) employment, and employment as a percentage of population.

Table 13: State And Local Employment (000) In October Of Various Years

Year	Total	FTE	Percent Of Population
1990	15,263	13,080	5.26%
1989	14,765	12,723	5.13
1988	14,476	12,404	5.05
1987	14,121	12,101	5.02
1986	13,913	11,853	4.92

Corrections Leads Employment Growth: The attempts to cut state spending to meet revenue shortfalls have usually included some type of control over staffing such as hiring freezes and layoffs. However, their impact has often been limited by exceptions found necessary for operations with fixed staffing ratios. Examples are the number of prison guards per wing, the number of nurse/attendants per ward, the number of parolees per parole officers, and the number of clients caseworkers are asked to handle. Within elementary and secondary education, local preferences and state mandates have been reducing the number of students handled per teacher. These two phenomena have tended to raise the ratio of population to employment. In fields like corrections, there have been increasing workloads. In fields like education, there has been richer staffing. The results are shown in the one-year increase in employment shown on Table 14.

During the year covered by Table 14, every major function except utilities had employment growth in excess of the population growth, which was about 1%. The hospital growth was artificially depressed by two factors: (1) the shift of mental health patients from state hospitals to community programs and (2) the shift of public hospitals to private or not-for-profit status.

Table 14: Percentage Increase in State And Local Employment, 1989-1990

Function	Percent Change	Workers (000)
Corrections	7.3%	513
Public Welfare	5.6	489
Health	5.0	356
Elementary And Secondary Education	3.7	5,572
All State And Local Activities	3.4	15,263
Higher Education	3.4	2,278
Fire Protection	3.2	327
Financial Administration	2.9	349
Police protection	2.6	754
Highways	2.2	569
Hospitals	1.9	1,145
Utilities (e.g., electric and water)	0.9	450

Employment Levels By State: Table 15 shows the October 1990 employment of each state in relation to its population.

Table 15: State and Local Government Employment
As a Percent of Population, October 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Pennsylvania	4.11%	18	West Virginia	5.14%	34	Colorado	5.60%
2	New Hampshire	4.46	19	Indiana	5.15	35	South Carolina	5.60
3	Rhode Island	4.70	20	Maryland	5.19	36	Alabama	5.63
4	California	4.76	21	Tennessee	5.21	37	Delaware	5.64
5	Connecticut	4.77	22	Maine	5.24	38	Hawaii	5.66
6	Missouri	4.79	23	Washington	5.24	39	Louisiana	5.69
7	Massachusetts	4.80		**United States**	5.26	40	Oklahoma	5.78
8	Ohio	4.83	24	North Carolina	5.29	41	Georgia	5.90
9	Illinois	4.91	25	Minnesota	5.34	42	Mississippi	5.90
10	Michigan	4.94	26	Oregon	5.37	43	Iowa	5.93
11	Arizona	5.07	27	New Jersey	5.38	44	Nebraska	6.16
12	Florida	5.07	28	South Dakota	5.40	45	Kansas	6.21
13	Nevada	5.07	29	Virginia	5.45	46	New York	6.40
14	Utah	5.10	30	Vermont	5.46	47	New Mexico	6.41
15	Wisconsin	5.11	31	Texas	5.47	48	Montana	6.45
16	Arkansas	5.12	32	North Dakota	5.48	49	Wyoming	7.78
17	Kentucky	5.14	33	Idaho	5.58	50	Alaska	7.86

The only meaningful comparison among states combines state and local employment. Some states (e.g., California and New York) have unusually low state totals but higher local totals because welfare workers are local employees there but state employees elsewhere. Teachers in Hawaii and local road workers in Delaware are state employees, giving those states higher state totals but lower local totals.

There are many reasons for the differences on Table 15. States that are heavy spenders, like Alaska and New York, have larger-than-average numbers of public employees. Another factor is the distribution of functions between private and public sectors. Georgia, Mississippi, and Wyoming have extraordinary numbers of hospital employees while New Hampshire and Rhode Island have almost none. A third of the states have liquor store employees, the rest don't. Nebraska supplies electric power through the public sector, an unusual arrangement. Most water is supplied by government employees, but private water utilities are common in New England.

Employee Compensation: According to the Census data, state and local employees didn't do particularly well in raising their compensation between October of 1989 and 1990. The average monthly earnings increased by 4.4%, which is about the rate of inflation. Average earnings are shown in Table 16. The rankings on the table bear some resemblance to other measures such as average pay in the private sector and per capita income. However, the mix of employees will also affect the averages.

Table 16: Average Monthly Earnings of State and Local Employees, October 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$3,518		**United States**	$2,395	34	Missouri	$2,026
2	California	$3,104	18	Hawaii	$2,368	35	Kansas	$2,011
3	Connecticut	$2,915	19	Delaware	$2,342	36	Texas	$2,008
4	New York	$2,846	20	Oregon	$2,316	37	Montana	$1,995
5	New Jersey	$2,742	21	Iowa	$2,305	38	Kentucky	$1,938
6	Maryland	$2,717	22	Ohio	$2,303	39	Tennessee	$1,935
7	Michigan	$2,708	23	New Hampshire	$2,259	40	Georgia	$1,919
8	Minnesota	$2,654	24	Virginia	$2,254	41	New Mexico	$1,905
9	Rhode Island	$2,627	25	Florida	$2,211	42	Alabama	$1,897
10	Nevada	$2,552	26	Vermont	$2,182	43	South Carolina	$1,891
11	Massachusetts	$2,550	27	Indiana	$2,170	44	West Virginia	$1,882
12	Washington	$2,496	28	North Carolina	$2,155	45	Idaho	$1,876
13	Arizona	$2,486	29	Maine	$2,106	46	Oklahoma	$1,835
14	Illinois	$2,477	30	North Dakota	$2,104	47	Louisiana	$1,827
15	Colorado	$2,413	31	Wyoming	$2,090	48	South Dakota	$1,820
16	Pennsylvania	$2,412	32	Nebraska	$2,084	49	Arkansas	$1,676
17	Wisconsin	$2,404	33	Utah	$2,052	50	Mississippi	$1,629

Recent Changes In Employment Levels: Using information from the Bureau of Labor Statistics, Steven Gold looked at employment in "What Has Happened To Government Employment In The Past Year." His paper, published by the Center for the Study of the States (411 State St., Albany, NY 12203) finds governments increasing employment from June of 1990 to June of 1991. Local employment rose 2.1% while state employment increased 1.3%.

There were sharp drops reported for a few state governments: Massachusetts (-6.0%), New York (-4.3%), Maine (-3.7%), Vermont (-3.5%), and Rhode Island (3.3%). There were also large increases led by Nevada (7.4%), South Carolina (6.9%), and Florida (5.8%).

TECHNICAL NOTES

Revenue Estimates: The outlying values in Tables 3 and 4 aren't all easily explained, but some are for reasons noted in the text and special cases noted here. The extreme overestimate of New York income tax probably is a misreporting by New York or misreading by **Reports** of accounting for that part of revenues included in one year and in a separate fund in the other. New Jersey errors are likely to be larger than those of other states because of extensive changes in the taxes involved. A large overestimate in income taxes in Connecticut is more plausible than other states because during FY 1991 the tax excluded relatively stable wages and salaries, so only dividends, interest, and capital gains were included. Virginia errors in FY 1991 estimating should be larger because its biennial budget cycle means its estimates were prepared a year sooner than those of other states. New Mexico's errors are implausible unless there was a major tax law or accounting change not reported. Misguessing the state's economy will produce errors in the same direction and of the same magnitude for sales and income taxes. New Mexico made the largest *under*estimate in the nation for sales tax and the fifth highest *over*estimate for the income tax.

Discrepancies In Reported Tax Increases: There are significant discrepancies in the executive and legislative reports of tax increases, such as those summarized in Table 7. Of course, underlying the differences in summary totals are differences in reporting for individual states. The differences arise: (1) from differences in estimates and estimating concepts in individual states and (2) from conceptual differences in how the two organizations calculate tax increases. One example is a sales tax increase effective the first day of a fiscal year that will, say, cause $100 million in added collections of which $85 million will occur in the new fiscal year and $15 million in the next. A state with full accrual accounting would say the tax raised $100 million. A cash accounting state would say $85 million. Most of the prior surveys would say $100 million on a full year implementation basis. Another example is renewal of a tax scheduled to expire, which some count as an increase and some don't.

Table A-1: Percentage Change In FY 1991 Spending

State	El. & Sec. Education	Higher Education	Cash Assistance	Medicaid	Corrections	Total
UNITED STATES	5.7%	5.6%	6.7	20.9	11.4	7.3
Alabama	6.4	7.9	-12.5	36.3	14.9	8.0
Alaska	4.0	3.9	11.7	36.7	10.9	6.3
Arizona	7.7	8.8	14.5	31.5	5.4	14.8
Arkansas	4.2	1.8	19.7	3.8	9.0	4.7
California	3.6	9.6	6.0	17.1	15.8	6.9
Colorado	7.0	-5.1	5.9	19.6	8.8	4.7
Connecticut	-7.0	7.2	15.4	30.6	30.5	3.9
Delaware	4.4	2.7	12.5	20.0	5.9	1.9
Florida	4.9	11.2	20.6	34.0	14.2	17.3
Georgia	2.3	-0.2	18.1	40.2	-9.2	4.3
Hawaii	10.1	8.1	9.5	3.1	10.0	3.9
Idaho	14.7	17.3	0.0	29.5	26.7	11.4
Illinois	2.3	3.7	5.5	13.4	13.3	8.0
Indiana	7.4	7.3	12.2	20.3	43.0	10.2
Iowa	10.0	11.3	-2.1	15.5	15.0	4.9
Kansas	1.3	5.0	-8.8	23.6	16.1	7.1
Kentucky	18.6	13.4	15.5	27.0	17.8	16.3
Louisiana	6.3	10.0	7.8	22.0	10.4	14.9
Maine	7.7	5.2	-5.4	10.8	-3.4	6.1
Maryland	6.4	5.8	13.0	4.9	1.8	1.3
Massachusetts	-14.5	-9.6	6.4	12.2	6.4	-0.7
Michigan	5.9	6.0	-8.6	-9.9	-10.3	1.4
Minnesota	26.5	8.2	19.4	16.3	14.1	11.3
Mississippi	2.6	5.5	4.2	12.5	17.1	13.1
Missouri	4.0	3.1	11.0	45.9	8.2	5.3
Montana	28.5	4.1	0.0	4.1	7.4	12.9
Nebraska	79.3	14.5	7.4	12.4	32.7	24.3
Nevada	n/a	n/a	n/a	n/a	n/a	n/a
New Hampshire	6.7	2.3	31.8	17.8	10.7	2.7
New Jersey	2.9	-5.7	8.8	17.3	17.0	4.0
New Mexico	7.8	6.0	22.7	18.4	2.0	-0.6
New York	1.0	-0.7	10.5	20.2	3.9	2.6
North Carolina	5.5	0.4	-28.1	15.6	2.0	7.4
North Dakota	5.8	-11.0	10.0	6.8	14.3	-17.2
Ohio	5.7	3.4	10.4	20.3	14.2	8.0
Oklahoma	20.1	5.1	7.6	10.1	14.1	10.5
Oregon	9.1	16.5	13.3	44.3	48.0	8.3
Pennsylvania	5.9	6.3	10.1	48.7	18.9	10.2
Rhode Island	-15.3	-9.0	21.9	16.1	13.2	-0.3
South Carolina	4.1	20.0	8.8	77.0	6.2	7.7
South Dakota	7.9	6.4	0.0	8.9	14.3	10.6
Tennessee	3.2	-2.5	19.0	23.3	3.7	6.0
Texas	12.2	5.9	21.1	34.5	21.5	11.1
Utah	10.1	8.8	8.7	18.8	21.5	11.1
Vermont	7.5	-1.7	25.0	31.7	7.4	3.0
Virginia	5.5	3.6	6.8	27.7	14.9	4.8
Washington	12.7	7.0	6.1	17.7	11.1	17.9
West Virginia	16.2	11.7	3.2	3.6	12.0	10.5
Wisconsin	6.9	0.7	0.0	8.7	89.7	8.4
Wyoming	-9.7	8.0	0.0	-13.6	17.4	-0.6